Kraton Performance Polymers, Inc.
Form 10-K
February 29, 2012
Table of Contents

Index to Financial Statements

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the fiscal year ended December 31, 2011

or

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

Commission file number

001-34581

KRATON PERFORMANCE POLYMERS, INC.

(Exact Name of Registrant as Specified in its Charter)

Delaware	**20-0411521**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
15710 John F. Kennedy Blvd, Suite 300 Houston, TX 77032	
(Address of principal executive offices, including zip code)	**281-504-4700 (Registrant s telephone number, including area code)**

Securities registered pursuant to Section 12(b) of the Act:

Title of Each Class	**Name of Each Exchange on Which Registered**
Kraton Performance Polymers, Inc. Common Stock, par value $0.01	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES x NO ¨

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. YES ¨ NO x

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

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 definitions of large accelerated filer , accelerated filer and smaller reporting company in Rule 12b-2 of the Securities Exchange Act. (Check one):

Large accelerated filer: x Accelerated filer: ¨ Non-accelerated filer: ¨ Smaller reporting company: ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). YES ¨ NO x

Estimated aggregate market value of the common equity held by nonaffiliates of Kraton Performance Polymers, Inc. at June 30, 2011: $1,249,068,040. Number of shares of Kraton Performance Polymers, Inc. Common Stock, $0.01 par value, outstanding at February 24, 2012: 32,103,523.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of Kraton Performance Polymers, Inc. s proxy statement for the 2012 Annual Meeting of Shareholders are incorporated by reference in Part III.

Table of Contents

Index to Financial Statements

Index to Annual Report

on Form 10-K for

Year Ended December 31, 2011

Table of Contents

Index to Financial Statements

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

Some of the statements in this Annual Report on Form 10-K under the headings Business, Risk Factors, Selected Financial Data, Management s Discussion and Analysis of Financial Condition and Results of Operations, Financial Statements and Supplementary Data and elsewhere contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. We may also make written or oral forward-looking statements in our periodic reports on Forms 10-Q and 8-K, in press releases and other written materials and in oral statements made by our officers, directors or employees to third parties. Statements that are not historical facts, including statements about our beliefs and expectations, are forward-looking statements. Forward-looking statements are often characterized by the use of words such as believes, estimates, expects, projects, may, intends, plans or anticipates, or by discussions of strategy, plans or intentions and in this report inclu statements regarding our general outlook ; our ability to obtain raw materials at competitive prices; anticipated benefits of or performance of our products; anticipated rates of growth, including sales growth and growth in product offerings through innovation; the outcome of our arbitration with LyondellBasell Industries N.V, or LyondellBassell; the terms of our new Operating Agreement with LyondellBassell; the impact of inflation on our results of operations and financial condition; our ability to realize certain deferred tax assets; estimates regarding the tax expense of repatriating certain cash and short-term investments related to foreign operations; expectations regarding our planned semi-works plant, including anticipated benefits of the facility; estimates related to the useful lives of certain assets for tax purposes; our anticipated dividend policy; adequacy of accruals for contingencies; anticipated growth in demand for Cariflex products; anticipated costs incurred by customers that switch vendors; costs, timing and plans related to our planned joint venture with Formosa Petrochemical Corporation and the related manufacturing facility; estimated future contributions to and assumptions regarding our employee benefit plans; adequacy of cash flows to fund working capital and anticipated capital expenditures; and expectations regarding counterparties ability to perform. Such forward-looking statements involve known and unknown risks, uncertainties and other important factors that could cause the actual results, performance or our achievements, or industry results, to differ materially from historical results, any future results, or performance or achievements expressed or implied by such forward-looking statements. There are a number of risks and uncertainties that could cause our actual results to differ materially from the forward-looking statements contained in this report. Important factors that could cause our actual results to differ materially from those expressed as forward-looking statements are set forth in this report, including but not limited to those under the heading Risk Factors. There may be other factors of which we are currently unaware or deem immaterial that may cause our actual results to differ materially from the forward-looking statements.

Forward-looking statements are based on current plans, estimates and projections, and, therefore, you should not place undue reliance on them. Forward-looking statements speak only as of the date they are made, and we undertake no obligation to update them publicly in light of new information or future events.

Presentation of Financial Statements.

The terms Kraton, our company, we, our, ours and us as used in this report refer collectively to Kraton Performance Polymers, Inc. and it consolidated subsidiaries.

This Form 10-K includes financial statements and related notes that present the consolidated financial position, results of operations and cash flows of Kraton, and its subsidiaries. Kraton is a holding company whose only material asset is its investment in Kraton Polymers LLC, which is its wholly owned subsidiary. Kraton Polymers LLC and its subsidiaries own all of the consolidated operating assets.

Table of Contents

Index to Financial Statements

PART I

Item 1. Business.

General

Our Company

We are a leading global producer of styrenic block copolymers (SBCs) and other engineered polymers. We market our products under the Kraton® brand. SBCs are highly-engineered synthetic elastomers, which we invented and commercialized almost 50 years ago, that enhance the performance of numerous end use products by imparting greater flexibility, resilience, strength, durability and processability. Our SBC polymers are typically formulated or compounded with other products to achieve improved, customer specific performance characteristics in a variety of applications. We focus on the end use markets we believe offer the highest growth potential and greatest opportunity to differentiate our products from competing products. Within these end use markets, we provide our customers with a broad portfolio of highly-engineered polymers that we believe are value-enhancing and, in many cases, critical to the performance of their products. We seek to maximize the value of our product portfolio by emphasizing complex or specialized polymers and innovations that yield higher margins than more commoditized products. We sometimes refer to these complex or specialized polymers or innovations as being more differentiated. Our products are typically developed using our proprietary, and in many cases patent-protected, technology and require significant engineering, testing and certification. In 2011, we were awarded 79 patents for new products or applications and at December 31, 2011, we had 1,136 granted patents and 286 pending patent applications. We believe our almost 50-year track record of innovation, long-standing customer relationships and global infrastructure position us well to successfully execute our strategies.

Our SBC products are found in many everyday applications, including disposable diapers, the rubberized grips of toothbrushes, razor blades and power tools and asphalt formulations used to pave roads. We also produce Cariflex™ isoprene rubber (IR) and isoprene rubber latex (IRL). Our Cariflex™ products are highly-engineered, non-SBC synthetic substitutes for natural rubber latex. Our IRL products, which have not been found to contain the proteins present in natural rubber latex and are, therefore, not known to cause allergies, are used in applications such as surgical gloves and condoms. We believe the versatility of IRL provides opportunities for new, high-margin applications. In addition to IRL, we have a portfolio of innovations at various stages of development and commercialization, including polyvinyl chloride (PVC), alternatives for wire, cable and medical applications, and polymers for use in slush molding for automotive applications, and our Nexar™ family of membrane polymers for applications such as water filtration and breathable fabrics.

Our total capacity as of December 31, 2011 was approximately 420 kilotons. We generated approximately $1,437.5 million of sales revenue and 303.0 kilotons of sales volume for the year ended December 31, 2011. In 2011, we generated 14.3% of our sales revenue from innovation-driven revenue, which we define as revenue from products or applications introduced in the preceding five years. Our customers are diversified by industry and geography with more than 800 customers in over 60 countries. We manufacture our polymers at five manufacturing facilities globally, including our flagship facility in Belpre, Ohio, as well as facilities in Germany, France, Brazil, and Japan. The facility in Japan is operated by an unconsolidated manufacturing joint venture.

We have had relationships with many of our customers for 15 years or more and work closely with our customers to design products that meet application-specific performance and quality requirements. We have a diverse customer base, with no single customer accounting for more than 10.0% of our sales revenue in 2011 and our top 10 customers together representing approximately 29.2% of our sales revenues in 2011. Because of the technical expertise and investment required to develop many of our product formulations and the lead times required to replace them, our customers would likely incur additional costs by changing to an alternative vendor.

Over the past several years, we have implemented a range of strategic initiatives designed to enhance our profitability and end use market position. These include fixed asset investments to expand our capacity in

Table of Contents

Index to Financial Statements

specialized products, to enhance productivity at our existing facilities and to reduce our fixed costs through headcount reductions, production line closures at our Pernis, the Netherlands, facility (Pernis) and system upgrades. During this period, we have substantially exited the footwear applications business, which typically yielded lower margins than our other core end use markets, and implemented pricing strategies designed to enhance our overall margins and return on invested capital. We believe these initiatives provide us with a platform to benefit from volume growth that may occur in our end use markets.

Corporate History

Prior to our initial public offering and related reorganization transactions in December 2009, we were an indirect wholly-owned subsidiary of TJ Chemical Holdings LLC and were indirectly owned by certain affiliates of TPG Capital, L.P., which we refer to collectively as TPG, and certain affiliates of J.P. Morgan Partners, LLC, which we refer to collectively as JPMP, and certain members of our management. We conduct our business through Kraton Polymers LLC and its consolidated subsidiaries. Prior to our initial public offering, Kraton Polymers LLC s parent company was Polymer Holdings LLC, a Delaware limited liability company. On December 16, 2009, Polymer Holdings LLC was converted from a Delaware limited liability company to a Delaware corporation and renamed Kraton Performance Polymers, Inc., which remains Kraton Polymers LLC s parent company. In addition, prior to the closing of the initial public offering, TJ Chemical was merged into (and did not survive the merger with) Kraton Polymers LLC. Our initial public offering was completed, and trading in our common stock on the New York Stock Exchange commenced, in December 2009. TPG and JPMP collectively owned a majority of our common stock following the initial public offering, and through two secondary public offerings conducted in September 2010 and April 2011, sold all of their holdings in our common stock. We did not receive any proceeds from these secondary offerings.

Recent Developments

Construction of a New Semi-Works Plant at our Belpre, Ohio, Facility. In December 2011, we finalized our plans for construction of a new semi-works plant at our Belpre, Ohio, facility. The new plant will replace our current pilot plant located at the Shell Westhollow Technology Center in Houston, Texas. The new semi-works pilot plant is expected to enhance our innovation and product development processes and reduce new product development cycle time. USBC and HSBC materials produced at the new plant will be used internally in our research and new product development efforts and will also be provided to customers for qualification and testing purposes. We also expect the plant to produce semi-commercial quantities that are currently produced on our large-scale production units, thereby reducing our reliance on commercial manufacturing facilities for test runs. We expect this capacity will result in improved utilization of our manufacturing lines. The new plant will be larger and will have more instrumentation than our existing pilot plant, and is expected to enable faster and more effective scale up to commercial production than our current facilities allow. Design and construction of the plant is expected to begin in 2012, and we currently expect the plant to be operational in the fourth quarter of 2013. We currently expect our 2012 capital expenditure for this project to be approximately $20.0 million, with the total capital expenditures estimated to be between $35.0 million and $40.0 million. We currently expect to fund 2012 expenditures for this project with operating cash flows.

Establishment of a Joint Venture Framework with Formosa Petrochemical Corporation. In July 2011, we announced the execution of a framework agreement with Formosa Petrochemical Corporation (FPCC), a leading global petrochemicals and plastics manufacturer, which sets forth the major terms and conditions that will, upon completion of the necessary definitive agreements, govern the formation of a 50/50 joint venture between the two companies to construct and operate a 30 kiloton HSBC plant to be located on FPCC s industrial site in Mailiao, Taiwan. The agreement establishes a framework between Kraton and FPCC for the commercial, operational, technical and management aspects of the planned joint venture company. The design of the joint venture plant will incorporate our proprietary polymerization technology, and the plant will produce our more differentiated HSBC polymer grades. The plant will be operated by the joint venture, and we will undertake the global marketing of all products manufactured at the facility. In October 2011 the Fair Trade Commission in

Table of Contents

Index to Financial Statements

Taiwan approved the proposed joint venture. Certain required approvals from the Taiwanese environmental authorities remain pending. We are currently continuing to work towards the completion of definitive documentation with FPCC which we anticipate being completed in the first half of 2012, subject to receiving all required regulatory approvals. In the fourth quarter of 2011, we advanced plans to expand HSBC capacity in Asia with FPCC. Currently, we are conducting an engineering estimate for the project, which we expect will be completed in March 2012 and will provide data to estimate narrower ranges of total project cost and timing. At this time we anticipate the total project cost estimate will reflect at least $200.0 million. The increase from the previously estimated range of $165.0 million to $200.0 million results principally from an expanded project scope as well as a more detailed assessment of site-specific requirements since entering the framework agreement with FPCC. We are currently targeting to have the plant operational in the first half of 2014. We currently estimate our share of the funding for the joint venture will be approximately $70.0 million in 2012. This estimate is dependent on a number of factors, including final project cost, timing, and the extent to which the project can be funded through third party debt financing, which will impact the equity contributions to be made by us and FPCC. We currently anticipate funding our 2012 contributions with available liquidity and/or through alternative incremental funding sources.

Products

Our Kraton polymer products are high performance elastomers that are engineered for a wide range of end use applications. Our products possess a combination of high strength and low viscosity, which facilitates ease of processing at elevated temperatures and high processing speeds. Our products can be processed in a variety of manufacturing applications, including injection molding, blow molding, compression molding, extrusion and hot melt and solution applied coatings.

We offer our customers a broad portfolio of products, including 250 core commercial grades of SBCs. Our products are manufactured along the following product lines based upon polymer chemistry and process technologies:

- unhydrogenated SBCs (USBCs);
- hydrogenated SBCs (HSBCs);
- isoprene rubber (IR) and isoprene rubber latex (IRL); and
- compounds.

The majority of worldwide SBC production is dedicated to USBCs, which are primarily used in paving and roofing, in adhesives, sealants and coatings and in footwear applications. HSBCs, which are significantly more complex and capital-intensive to manufacture than USBCs, are used in applications such as soft touch and flexible materials, personal hygiene products, medical products, automotive components and certain adhesives and sealant applications.

Below is an overview of our four product lines. Sales revenue percentages included in our product line discussion are based on revenues excluding $4.6 million of other sales revenue in 2011 and $47.6 million of by-product sales revenue reported as other revenues in 2009.

USBCs. We developed the first USBC polymers in 1964 and built the first dedicated block copolymer facility in Belpre, Ohio, in 1971. As of December 31, 2011, our USBC product portfolio included 119 core commercial grades of products. Sales of USBC products comprised approximately 59.5%, 59.1% and 56.6% of our sales revenue in 2011, 2010 and 2009, respectively.

USBCs are used in three of our core end use markets (Advanced Materials, Adhesives, Sealants and Coatings, and Paving and Roofing) in a range of products to impart performance characteristics such as: (1) resistance to temperature and weather extremes in roads and roofing; (2) resistance to cracking, reduced sound transmission and better drainage in porous road surfaces; (3) impact resistance for consumer plastics; and

Table of Contents

Index to Financial Statements

(4) increased processing flexibility in adhesive applications, such as packaging tapes and labels, and materials used in disposable diapers. As with SBCs in general, USBCs are most often blended with substrates.

HSBCs. We developed the first HSBC polymers in the late 1960s for use in production of soft, strong compounds for handles and grips and elastic components in diapers. As of December 31, 2011, our HSBC product portfolio included 89 core commercial grades of products. HSBC products are significantly more complex to produce than USBC products and, as a result generate higher margins than USBCs. Sales of HSBC products, comprised 31.7%, 31.2% and 31.6% of our sales revenue in 2011, 2010 and 2009, respectively.

HSBCs are primarily used in our Advanced Materials and Adhesives, Sealants and Coatings end use markets to impart performance characteristics such as: (1) stretch properties in disposable diapers and adult incontinence products; (2) soft feel in numerous consumer products such as razor blades, power tools, and automobile internals; (3) impact resistance for demanding engineering plastic applications; (4) flexibility for wire and cable plastic outer layers; (5) improved flow characteristics for many industrial and consumer sealants lubricating fluids; (6) resistance to ultraviolet light; (7) processing stability and viscosity; and (8) elevated temperature resistance.

IR and IRL. We market our IR and IRL products under the Cariflex™ brand name. These products combine the key qualities of natural rubber, such as good mechanical properties and hysteresis, with purity and clarity enhancements, good flow, low gel content, and absence of nitrosamines and natural rubber proteins. As of December 31, 2011, our IR and IRL product portfolio included 11 core commercial grades of products. IR and IRL comprised 6.9%, 7.5% and 9.1% of our sales revenue in 2011, 2010 and 2009, respectively.

Isoprene rubber (formed from polymerizing isoprene) is a line of high purity isoprene rubber products and is a non-SBC product. Our IR polymers are available as bales of rubber or as latex. We focus our IR polymers, produced using nanotechnology, in demanding applications such as medical products, adhesives and tackifiers, paints, coatings and photo-resistors. Isoprene rubber latex (emulsion of IR in water) is a substitute for natural rubber latex, particularly in applications with high purity requirements, such as medical, healthcare, personal care and food contact operations. Our IRL is a specialized polyisoprene latex with a controlled structure and low chemical impurity levels obtained through an anionic polymerization process followed by a proprietary latex processing step, both of which were first developed by us. IRL is durable, tear resistant, soft, transparent and odorless. In addition, the synthetic material is non-allergenic and has superior consistency and other advantages to natural rubber latex. IRL is predominately used in the synthetic surgical gloves and condoms.

During the second quarter of 2011, we commissioned a line conversion project at our Belpre, Ohio, facility, which now provides for production of IR and replaces production capacity at our former manufacturing facility in the Netherlands that was closed in 2009. During 2011, we also successfully completed the expansion of our IRL capacity at our Paulinia, Brazil facility. Further, we executed a contract with our supplier in Japan to expand the manufacturing capability of IRL. The expansion, which is slated to be completed in mid-2013, is expected to double our existing capacity in Japan. These important projects will support anticipated continuing growth in demand for our Cariflex™ products.

Compounds. Our Compounds are a mixture of Kraton polymers and other polymers, resins, oils or fillers and cover a wide range of polymers used in consumer and industrial applications. Compounds can be formulated so that they meet the specific requirements of our customers. These products are primarily used in soft-touch grips, sporting equipment, automotive components and personal care products. As of December 31, 2011, our Compounds product portfolio included 31 core commercial grades of products. Compounds comprised 1.9%, 2.2% and 2.7% of our sales revenue in 2011, 2010 and 2009, respectively.

Our End Use Markets

Our commercial activities are aligned to serve our four core end use markets: (1) Advanced Materials; (2) Adhesives, Sealants and Coatings; (3) Paving and Roofing; and (4) Cariflex™. In 2011, we realigned our core

Table of Contents

Index to Financial Statements

end use markets. The Emerging Businesses end use, which previously was comprised primarily of IR and IRL sales, has been renamed Cariflex™, and IR sales previously reported in our Advanced Materials and in our Adhesives, Sealants and Coatings end use markets are now reported in the Cariflex™ end use. Additionally, sales of lubricant additives, which were previously not included in our four core end uses, are now reported in our Adhesives, Sealants and Coatings end use.

The following table provides sales revenue information as well as examples of selected applications for each of our core end use markets. Percentages of sales revenue and other data for our core end use markets are reported below on this realigned basis for 2011, as well as for prior periods.

	Revenue Mix (1)			
End Use Markets	**2011**	**2010**	**2009**	**Selected Applications/Products**
Advanced Materials	28.0%	29.8%	28.8%	Consumer disposable and consumer durable soft touch Engineering thermoplastics compatibilization and impact modification Personal care PVC, alternatives for medical, wire and cable Disposable food packaging and closures Highly engineered polymer modification Skin care products and lotions Automotive interior and exterior Stoppers for medical/pharmaceutical
Adhesives, Sealants and Coatings	34.8%	34.3%	34.9%	Tapes and labels Non-woven and industrial adhesives Clear sealants Lubricant additives
Paving and Roofing	29.9%	27.8%	26.4%	Asphalt modification for performance roadways, bridges and airports Asphalt modification for roofing felts and shingles
Cariflex™	6.9%	7.5%	9.1%	Surgical gloves Condoms
Other	0.4%	0.6%	0.8%	High styrenics packaging Footwear Other

(1) Based on 2011, 2010 and 2009, sales revenue of $1,437.5 million, $1,228.4 million and $920.4 million, respectively. Excluded from the table is $47.6 million of sales of by-products associated with production at Pernis (which we exited in 2009) that are not associated with sales of our core end use markets.

Advanced Materials. We sell HSBC, USBC, and customized SBC based compounds, across multiple markets as part of the Advanced Materials end use market.

Our products primarily compete against a variety of chemical and non-chemical alternatives including, but not limited to, thermoplastic vulcanizate, thermoplastic polyurethane (TPU), PVC, thermoplastic polyolefin, polyethylene terephthalate, polycarbonate, polyamide, and ethylene-propylene-diene-monomer (EPDM) based products. We believe the ability to balance performance characteristics such as ease of use, desired aesthetics, haptics, and managing total end product costs are principal factors influencing final product decisions of our customers in this end use market.

Table of Contents

Index to Financial Statements

Many of our products in this core end use market are customized formulations that are highly engineered to address specific customer needs, such as improved stretch and resilience characteristics in elastic film applications. As such, they require specialized product testing and validation, production and process evaluation. This results in long lead time to achieve customer and industry established approvals.

We believe demand for products in this end use market is principally driven by customer-specific needs and cost. Our innovation led growth strategy focuses on translating the inherent strengths of our product technologies such as flexibility, resilience, impact and moisture resistance, and aesthetics (clarity and haptics), and target opportunities where we can expand and/or have the potential to create new market spaces for our solutions.

Adhesives, Sealants and Coatings. We sell HSBC and USBC products in the Adhesives, Sealants and Coatings end use market.

Our products primarily compete with acrylics, silicones, solvent-based rubber systems and thermoplastic polyolefin elastomers. The choice between these materials is influenced by bond strength, specific adhesion, consistent performance to specification, processing speed, hot-melt application, resistance to water and total end-product cost.

Our SBCs are used in applications such as adhesives for diapers and hygiene products, sealants and coatings for construction and automotive applications, elastomeric white roof coatings and adhesives for tapes and labels. Our SBCs in this end use market are compatible with many other formulating ingredients. Due to the limited supply of hydrocarbon resins, we continue to work on SBC modified products that reduce the amount of resin required to formulate an adhesive, delivering similar cost and performance. We have expanded our offering of formulated compounds for both hydrocarbon tackifying resin reduction alternatives and solvent free co-extrusion adhesives for protective films that provide improved adhesive performance with no residue or haze after removal, both of which are commercialized.

We believe demand for products in this end use market is driven largely by the consumption of disposable hygiene products that contain adhesives, particularly in elastic attachment. Further, we believe that cost reduction and consumer market appeal are principal factors driving increasing use of SBC based adhesives relative to paper labels in the pressure sensitive label market. The trend towards utilization of SBC based adhesives is primarily driven by cost reduction and higher performance.

Paving and Roofing. We sell USBC products in the Paving and Roofing end use markets.

Our products primarily compete with chemicals such as styrene-butadiene rubber latex, acetates, polyphosphoric acids, and thermoplastic materials like EPDM, polyethylene, atactic polypropylene and unmodified asphalts. We believe that customer choice in this end use market is driven principally by total end-product cost, temperature performance, bitumen source, and application.

Styrene-butadiene-styrene (SBS)-modified asphalt pavements enhance the strength and elasticity of asphalt-based paving compositions over an extended temperature range, thus increasing resistance to wear, rutting and cracking and therefore extending service life. In roofing applications, SBS-modified asphalt produces stronger and more durable felts and shingles, thus reducing the possibility of damage from weather, ice and water build-up and again extending service life.

We believe the ability to maintain roads in an environment where traffic demands are rising and repair budgets are decreasing is the primary issue facing governments and other road owners in every region and a principal driver of demand in this end use market. Our recent commercialization of our Highly Modified Asphalt Technology (HiMA) polymers provided better rut and cracking resistance than other elastic binders, while achieving 25-40% reduction in road thickness without any major sacrifice of viscosity or temperature

Table of Contents

Index to Financial Statements

performance. We believe this innovation will extend road life by allowing pavements to withstand heavy traffic loads and varying climate conditions.

Cariflex™. We sell IR and IRL in this end use market. We primarily supply the surgical glove, condom and specialty medical device markets.

Our products primarily compete with natural rubber, conventional Ziegler Natta sourced solid IR, halo butyl rubber and several synthetic latex alternatives, notably neoprene, nitrile and polychloroprene latex rubber, as well as polyurethane.

In the medical device markets, we believe that demand for products is driven by purity of the product (including metal residuals content, the absence of natural rubber proteins and plasticisers.) and mechanical properties applicable to surgical gloves, stoppers, closure and other packaging applications. In coatings applications, we believe that demand is driven by the level of impurity, as low levels facilitate more durable coatings that compete with epoxy coating systems. In electronic applications, we believe that demand is driven primarily by low metal content, which we believe reduces the likelihood of quality issues.

The surgical glove and condom markets are largely sourced by natural rubber latex products. However, we have seen a trend in surgeons using gloves made from synthetic latex alternatives, such as our IRL products. We believe this trend is driven by efforts to avoid allergies to natural rubber proteins, as well as comfort, consistent stretch and wearability factors imparted by synthetic latex such as our IRL. We have seen a similar trend in the market for condoms, which we believe is driven by these same factors.

Research, Development and Technology

Our research and development program is designed to develop new products and applications, provide technical service to customers, develop and optimize process technology, and assist in marketing new products. We spent $28.0 million, $23.6 million, and $21.2 million for research and development for the years ended December 31, 2011, 2010, and 2009, respectively. From time to time, we also engage in customer-sponsored research projects; with average spending of approximately $1.0 million a year for the three-year period ended December 31, 2011. As of December 31, 2011, we had 125 employees dedicated to research and development.

Our research and development activities are primarily conducted in laboratories in Houston, Texas, and Amsterdam, the Netherlands. We also own a laboratory in Paulinia, Brazil, that provides technical services to our South American customers. Our application and technical service laboratories in Shanghai, China and Tsukuba, Japan provide support to our Asian customers. In addition, we have technical service staff located in Mont St. Guibert, Belgium.

Our professionals perform research using scientific application equipment located primarily at our Houston, Texas, Amsterdam, the Netherlands and Shanghai, China research and development facilities. At all of our major research and development facilities, we produce new Kraton product samples for our customers and provide guidance to our manufacturing organization. Application equipment is used to evaluate polymers and compounds to determine optimal formulations.

Sales and Marketing

Our business is predominantly based on a short sales cycle. We sell our products through a number of channels including a direct sales force, marketing representatives and distributors. The majority of our products are sold through our direct sales force. In countries where we generate substantial revenues, our sales force is organized by end use market in order to meet the specific needs of our customers. In geographic areas where it is not efficient for us to organize our sales force by end use market, we may use one sales team to service all end use markets.

In smaller markets, we often utilize marketing representatives who act as independent contractors to sell our products. In addition, we utilize distributors to service our smaller customers in all regions. Distributors sell a

Table of Contents

Index to Financial Statements

wide variety of products, which allows smaller customers to obtain multiple products from one source. In addition to our long-term relationships with distributors in North America and Europe, we have established relationships with a wide network of distributors in Latin America and the Asia Pacific region.

Our direct sales force, marketing representatives and distributors interact with our customers to provide both product advice and technical assistance. In general, they arrange and coordinate contact between our customers and our research and development personnel to provide quality control and new product solutions. Our close interaction with our customers has allowed us to develop and maintain what we consider to be strong customer relationships.

Total operating revenues from our operations outside the United States were approximately 65.9%, 65.7%, and 66.8% of our total operating revenues in the years ended December 31, 2011, 2010, and 2009, respectively. Direct sales we make outside of the United States are generally priced in local currencies and can be subject to currency exchange fluctuations when reported in our consolidated financial statements, which are maintained in U.S. dollars in accordance with U.S. Generally Accepted Accounting Principles (GAAP). For geographic reporting, revenues are attributed to the geographic location in which the customers facilities are located. We generated approximately 41.0%, 40.0% and 19.0% of our 2011 total operating revenues from customers located in the Americas, Europe and Asia Pacific region, respectively. See Note 13 *Industry Segment and Foreign Operations* to the consolidated financial statements for geographic reporting of total operating revenues and long-lived assets as of and for the years ended December 31, 2011, 2010, and 2009.

Sources and Availability of Raw Materials

We use butadiene, styrene and isoprene as our primary raw materials (also referred to as monomers) in manufacturing our products. The monomers used by our U.S. and European facilities are predominantly supplied by a portfolio of suppliers under long-term supply contracts and arrangements with various expiration dates. For our U.S. facilities, we also procure a substantial amount of isoprene from various suppliers in Russia, China and Japan. These purchases include both spot and contract arrangements. We generally contract with these suppliers on a short-term basis and have increased the number of these contracts to enhance the availability of our isoprene supply. Our facility in Paulinia, Brazil, generally purchases all of its raw materials from local third-party suppliers. In Japan, butadiene and isoprene are supplied under our joint venture agreement with JSR Corporation. Styrene in Japan is sourced from local third-party suppliers. We believe our contractual and other arrangements with suppliers of butadiene, styrene, and isoprene provide an adequate supply of raw materials at competitive, market-based prices. However, we can provide no assurances that contract suppliers will not terminate these contracts at the expiration of their contract terms, that we will be able to obtain substitute arrangements on comparable terms, or that we generally will be able to source raw materials on an economic basis in the future. If we are unable to obtain one or more of these monomers at competitive prices and necessary levels, or at all, our ability to produce products that use such monomers would be adversely impacted.

Butadiene. Butadiene is available on the global petrochemical market with approximately eight producers in the Americas, 29 in Europe, 48 in Asia and seven in the Middle East. Prices for butadiene are impacted by worldwide supply and demand for butadiene and natural rubber and prevailing energy prices. We believe our contractual and other arrangements with our suppliers will generally provide adequate supplies of butadiene at competitive prices to support our current sales levels. Butadiene prices were volatile in 2011 and 2010, and production of our products above our current sales levels that require butadiene could be limited by our ability to source additional butadiene at competitive prices.

The North American market is structurally short of butadiene and has relied on imports of crude C4 and/or butadiene to balance demand. We currently source butadiene in the United States pursuant to contractual arrangements with maturities up to the end of 2013, subject to renewal conditions. Prices for U.S. butadiene vary with the published prices for butadiene on world markets. Due to political unrest in Libya and U.S. sanctions that

Table of Contents

Index to Financial Statements

were imposed upon the Libyan government, crude C4 exports to the United States from Libya were interrupted , and this could affect our ability to obtain butadiene in the United States in the quantities or at the prices we require. Although we have supplemented our requirements of butadiene by purchasing spot supply as needed, no assurances can be given that we will be able to obtain adequate supplies of butadiene at competitive prices in the future.

We currently source our butadiene in Europe pursuant to contracts and arrangements with LyondellBasell. The contract covering Germany will expire on December 31, 2040, and will be renewed automatically at the conclusion of the current term unless terminated with prior written notice by either party. We are presently acquiring butadiene in France from LyondellBasell under interim arrangements, pending resolution of an agreed arbitration between the parties to determine, among other matters, the effect of a term sheet previously reached between the parties that had been governing Butadiene purchases by us from LyondellBasell at Berre from January 2009 until September 2010. In this regard, we can provide no assurance as to the nature of any final arrangement whereby we will continue to purchase butadiene from LyondellBasell at Berre, including, without limitation, the volumes, prices or terms of sale that would be applicable to any such final arrangement. The price we pay for butadiene under our arrangements or agreements covering France and Germany vary based upon the published price for butadiene, the amount of butadiene purchased during the preceding calendar year and/or the cost of butadiene manufactured.

In Brazil, butadiene is obtained from a local third-party source. In Kashima, Japan, a majority of our butadiene needs are sourced from JSR Corporation (JSR) on a commercial supply basis.

Styrene. Styrene is available on the global petrochemical market with approximately 11 producers located in the Americas, 18 in Europe, 50 in Asia and five in the Middle East. The top five producers worldwide are: BASF, Shell Chemicals, LyondellBasell, Total and Sinopec. Styrene prices are principally driven by worldwide supply and demand, the cost of ethylene and benzene, and prevailing energy prices.

We satisfy our styrene requirements in the United States and Europe pursuant to purchase agreements with maturities up to the end of 2013, subject to renewal conditions. We have more than one supplier in each of these regions and also generally have alternatives for either modifying the contract, supply portfolio or obtaining spot supply. As contracts expire, we cannot give assurances that we will obtain new long-term supply agreements or that the terms of any such agreements will be on terms favorable to us, and consequently our future acquisition costs for styrene may therefore increase.

Isoprene. Isoprene is primarily produced and consumed captively by manufacturers for the production of IR, which is primarily used in the manufacture of rubber tires. As a result, there is limited non-captive isoprene available in the market place. Prices for isoprene are impacted by the supply and prices of natural and synthetic rubber, prevailing energy prices and the existing supply and demand of isoprene in the market.

We source our global isoprene requirements through several contractual arrangements. We also purchase additional supplies of isoprene from various suppliers at prevailing market prices. In Kashima, Japan, the majority of our isoprene needs are sourced from JSR on a commercial supply basis and from alternative suppliers as needed.

We have historically had adequate supplies of isoprene. However, we have periodically experienced periods of limited supply due to operational problems at key producers, due to limited availability of crude raw materials for the isoprene extraction units. During these periods, we have normally been able to meet most of our needs by acquiring relatively expensive isoprene from other suppliers. For example, supply constraints in 2009 limited isoprene purchases under some of our existing contracts and we satisfied our requirements by supplementing purchases from a variety of other suppliers. Going forward, we believe our contractual arrangements with several

Table of Contents

Index to Financial Statements

suppliers as well as spot arrangements and longstanding relationships with other third-party suppliers of isoprene will generally provide adequate future supplies of isoprene at competitive prices to support our current sales levels. Production of our products that require isoprene could be limited by our ability to source additional isoprene at competitive prices, and we can provide no assurances in this regard.

Competition

We compete with other SBC producers and non-SBC product producers primarily on the basis of price, breadth of product availability, product quality and speed of service from order to delivery. We believe our customers also base their supply decisions on the supplier s ability to design and produce custom products and the availability of technical support. See *Part I, Item 1. Business* for further discussion of competition in our end use markets.

SBC Industry. Our most significant competitors in the SBC industry are: Asahi Chemical, Chi Mei, Dynasol Elastomers, Kuraray Company, Korea Kumho P.C., Lee Chang Yung, LG Chemical, Polimeri Europa, Sinopec, Taiwan Synthetic Rubber Corporation and Zeon Corporation. Generally, however, we believe individual competitors do not compete across all of our end use markets.

Product Substitution. We also compete against a broad range of alternative, non-SBC products within each of our end use markets. See *Part I, Item 1. Business* for further discussion of product substitution in our end use markets.

Operating and Other Agreements

Operating Agreements. LyondellBasell operates our manufacturing facility located in Berre, France. This facility is situated on a major LyondellBasell refinery and petrochemical site at which other third party tenants also own facilities. LyondellBasell charges us fees based on certain costs incurred in connection with operating and maintaining this facility, including the direct and indirect costs of employees and subcontractors, reasonable insurance costs, certain taxes imposed on LyondellBasell (other than income taxes) and depreciation and capital charges on certain assets. Pursuant to the agreement, LyondellBasell employs and provides all staff, other than certain managers, assistant managers and technical personnel whom we may appoint. The original agreement had an initial term of 20 years, beginning in February 2001, indefinitely renewing automatically for consecutive five-year periods. A new operating agreement is being finalized, with an initial term through December 31, 2014 and shall continue thereafter for an indefinite period, if not terminated earlier with 18 months notice by either party.

Pursuant to an agreement dated March 31, 2000, LyondellBasell operates and provides certain services, materials and utilities required to operate our manufacturing facility in Wesseling, Germany. We pay LyondellBasell a monthly fee, as well as costs incurred by LyondellBasell in providing the various services, even if the facility fails to produce any output (whether or not due to events within LyondellBasell s control), and even if we reject some or all output. This agreement has an initial term of 40 years and will automatically renew subject to five years prior written notice of non-renewal. This agreement will terminate at any earlier date as of which the facility can no longer operate in a safe and efficient manner.

Site Services, Utilities, Materials and Facilities Agreements. LyondellBasell, through local operating affiliates, provides various site services, utilities, materials and facilities for the Berre, France, and Wesseling, Germany, manufacturing sites. Generally, these services, utilities, materials and facilities are provided by LyondellBasell on either a long-term basis, short-term basis or a sole-supplier basis. Items provided on a sole-supplier basis may not be terminated except upon termination of the applicable agreement in its entirety. Items provided on a long-term or short-term basis may be terminated individually under certain circumstances.

Information Systems

We utilize ERP software systems to support each of our facilities worldwide. In 2009, we upgraded our ERP software systems utilizing a single global system, which provided increased reliability of our systems, and

Table of Contents

Index to Financial Statements

implementing best practices for our industry. The ERP software systems are supported by internal resources. We also have in place a laboratory quality assurance system; including bar code based material management systems and manufacturing systems. An annual disaster recovery exercise is performed on critical systems utilizing third-party data centers.

Patents, Trademarks, Copyrights and Other Intellectual Property Rights

We rely on a variety of intellectual property rights to conduct our business, including patents, trademarks and trade secrets. As of December 31, 2011, approximately 20% of our patent portfolio (286 of 1,422) consisted of patent applications (the majority of which were filed after 2003). In light of the fact that patents are generally in effect for a period of 20 years as of the filing date, this means that a significant portion of the portfolio would remain in effect for a long period (assuming most of these applications will be granted). The granted patents and the applications cover both the United States and foreign countries. We do not expect that the expiration of any single patent or specific group of patents would have a material impact on our business. Our material trademarks will remain in effect unless we decide to abandon any of them, subject to possible third-party claims challenging our rights. Similarly, our trade secrets will preserve their status as such for as long as they are the subject of reasonable efforts, on our part, to maintain their secrecy. A significant number of patents in our patent portfolio were acquired from Shell Chemicals. Shell Chemicals retained for itself fully-transferable and exclusive licenses for their use outside of the elastomers field, as well as fully-transferable, non-exclusive licenses within the field of elastomers for certain limited uses in non-competing activities. Shell Chemicals is permitted to sublicense these rights. Shell Chemicals also retains the right to enforce these patents outside the elastomers field and recover any damages resulting from these actions. Shell Chemicals may engage in or be the owner of a business that manufactures and/or sells elastomers in the elastomers field, so long as they do not use patent rights or technical knowledge exclusively licensed to us.

As a general matter, our trade names are protected by trademark laws. Our products are marketed under the registered trademarks Kraton , Elexar , Giving Innovators Their Edge , Nexar and Cariflex.

In our almost 50 years in the SBC business, we have accumulated a substantial amount of technical and business expertise. Our expertise includes: product development, design and formulation, information relating to the applications in which our products are used, process and manufacturing technology, including the process and design information used in the operation, maintenance and debottlenecking of our manufacturing facilities, and the technical service that we provide to our customers. We hold extensive discussions with customers and potential customers to define their market needs and product application opportunities. Where we believe necessary, we have implemented trade secret protection for our technical knowledge through non-analysis, secrecy and related agreements.

Employees

We had 916 full-time employees at December 31, 2011. In addition, 175 LyondellBasell manufacturing employees operate our manufacturing facilities and provide maintenance services in Europe under various operating and services arrangements. See *Operating and Other Agreements*. None of our employees in the United States are subject to collective bargaining agreements. In Europe, Brazil and Japan, a significant number of our employees are in arrangements similar to collective bargaining arrangements. We believe our relationships with our employees continue to be good.

Environmental Regulation

Our operations in the United States and abroad are subject to a wide range of environmental laws and regulations at the national, state and local levels. These laws and regulations govern, among other things, air emissions, wastewater discharges, solid and hazardous waste management, site remediation programs and chemical use and management.

Table of Contents

Index to Financial Statements

Pursuant to these laws and regulations, our facilities are required to obtain and comply with a wide variety of environmental permits for different aspects of their operations. Generally, many of these environmental laws and regulations are becoming increasingly stringent and the cost of compliance with these various requirements can be expected to increase over time.

For example, the U.S. Environmental Protection Agency (EPA) issued new maximum achievable control technology (MACT) standards for controlling hazardous air emissions from industrial boilers. The Boiler MACT standards are required under Sections 112 of the Clean Air Act. The Boiler MACT rule applies to the coal-burning boilers at our Belpre, Ohio, facility. The final rule was published in the Federal Register on March 21, 2011 and was to have become effective 60 days later on May 20, 2011, if it was not otherwise changed or delayed. On May 16, 2011, the EPA announced a stay and reconsideration of the Boiler MACT rule and established a new comment period, which was open until July 15, 2011, in order to allow the EPA to continue to seek additional public comment before proposing a revised Boiler MACT rule. In December 2011, the EPA proposed a reconsidered Boiler MACT rule in lieu of the March 2011 version that was subject to a 60-day comment period. Litigation against the EPA by environmental interest groups resulted in the EPA s delay notice being vacated by the Federal court in January 2012. The Boiler MACT rule will likely impact the operation of the Belpre coal-burning boilers after the compliance date. Capital expenditures necessary to comply with the Boiler MACT rule are estimated to be $40.0 million to $50.0 million, of which approximately $0.9 million was incurred in 2011, $2.2 million is expected to be incurred in 2012 and the balance is expected to be incurred between 2013 and 2015, if the above rule is finalized.

Environmental laws and regulations in various jurisdictions also establish programs and, in some instances, obligations to clean up contamination from current or historic operations. Under some circumstances, the current owner or operator of a site can be held responsible for remediation of past contamination regardless of fault and regardless of whether the activity was legal at the time that it occurred. Evaluating and estimating the potential liability related to site remediation projects is a difficult undertaking, and several of our facilities have been affected by contamination from historic operations.

Our Belpre, Ohio, facility is the subject of a site investigation and remediation program administered by the EPA pursuant to the Resource Conservation and Recovery Act (RCRA). In March 1997, Shell Chemicals entered into a consent order to investigate and remediate areas of contamination on and adjacent to the site. In March 2003, we joined Shell Chemicals in signing a new consent order that required additional remediation and assessment of various areas of contamination and continues to require groundwater-monitoring and reporting. Shell Chemicals continues to take the lead in this program, has posted financial assurance of $5.2 million for the work required under the consent order and has also indemnified us for the work required under this program, subject to the condition that we provide notice of any claims on or prior to February 28, 2021. In turn, we have agreed with Shell Chemicals that we will, for a fee, provide certain services related to the remediation program. We have agreed with Shell Chemicals that we will pay up to $100,000 per year for the groundwater monitoring associated with the 2003 consent order.

Our Brazilian facility has also been affected by prior Shell Chemicals operations. A Shell Chemicals pesticide manufacturing operation was previously located on a tract of land adjacent to our Brazilian facility. In addition, areas of our facility were used by Shell Chemicals as part of its crop protection business. Shell Chemicals has retained responsibility for remediating a former manufacturing facility located on our site and has also indemnified us for identified waste management areas used in prior operations. The indemnity for remediation relating directly to the facility for the previous pesticide manufacturing operations and for disposal activity related to that facility and for third-party claims regarding hazardous substance disposal expires in 2021. Shell Chemicals has installed a hydraulic barrier to prevent migration of ground water contamination and has completed other cleanup actions on the site.

Table of Contents

Index to Financial Statements

Shell Chemicals agreed to indemnify us for specific categories of environmental claims brought with respect to matters occurring before our separation from Shell Chemicals in February 2001. Coverage under the indemnity varies depending upon the nature of the environmental claim, the location giving rise to the claim and the manner in which the claim is triggered. The indemnity for specific site clean-up matters and for third-party claims regarding hazardous substance disposal expires in 2021. Claims that may arise in the future related to past operations may not be covered by the Shell Chemicals indemnities and amounts that are recoverable under those indemnities may not be sufficient to satisfy claims against us.

In addition, we may in the future be subject to claims that arise solely from events or circumstances occurring after February 2001 that would not, in any event, be covered by the Shell Chemicals indemnity. While we recognize that we may, in the future, be held liable with respect to remediation activities beyond those identified to date, at present we are not aware of any circumstances that are reasonably expected to give rise to remediation claims that would have a material adverse effect on our results of operations or cause us to exceed our projected level of anticipated capital expenditures.

Insurance

We have levels of insurance that we believe to be customary for a company of our size in our industry. Our insurance policies are subject to customary deductibles and limits.

Seasonality

Seasonal changes and weather conditions, although difficult to predict, typically affect the Paving and Roofing end use market resulting in higher sales volumes into this end use market in the second and third quarters of the calendar year versus the first and fourth quarters. Our other end use markets tend to show relatively little seasonality.

Available Information

We electronically file reports with the Securities and Exchange Commission (SEC), including annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to such reports. The public may read and copy any materials that we file with the SEC at the SEC s Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains an internet site that contains reports and information statements, and other information regarding issuers that file electronically with the SEC at *http://www.sec.gov.* Additionally, information about us, including our reports filed with the SEC, is available through our web site at *http://www.kraton.com.* Such reports are accessible at no charge through our web site and are made available as soon as reasonably practicable after such material is filed with or furnished to the SEC. Our website and the information contained on that site, or connected to that site, are not incorporated by reference into this report.

Item 1A. Risk Factors.

Conditions in the global economy and capital markets may adversely affect the company s results of operations, financial condition and cash flows.

Our products are sold in markets that are sensitive to changes in general economic conditions, such as automotive and construction products. Downturns in general economic conditions can cause fluctuations in demand for our products, product prices, volumes and margins. A decline in the demand for our products or a

Table of Contents

Index to Financial Statements

shift to lower-margin products due to deteriorating economic conditions could adversely affect sales of our products and our profitability and could also result in impairments of certain of our assets.

Our business and operating results have been affected by the ongoing global recession, dislocations in the housing and commercial real estate markets, fluctuating commodity prices, volatile exchange rates and other challenges currently affecting the global economy and our customers. The recent European debt crisis and related European financial restructuring efforts have contributed to instability in European markets in which we operate. Uncertainty regarding global economic conditions poses a continuing risk to our business, as consumers and businesses may postpone spending in response to tighter credit, negative financial news or declines in income or asset values, which may reduce demand for our products. If global economic and market conditions, or economic conditions in key markets such as Europe, remain uncertain or deteriorate further, our results of operations, financial condition and cash flows could be materially adversely affected.

LyondellBasell Industries provides significant operating and other services under agreements that are important to our business. The failure of LyondellBasell to perform its obligations, or the termination of these agreements, could adversely affect our operations.

We have operating and service agreements with LyondellBasell Industries, or LyondellBasell, that are important to our business. We are a party to:

- operating agreements pursuant to which LyondellBasell (in Berre, France, and Wesseling, Germany) operates and maintains our European manufacturing facilities and employs and provides almost all of the staff for those facilities;
- site services, utilities, materials and facilities agreements pursuant to which LyondellBasell provides utilities and site services to our European manufacturing facilities; and
- lease agreements pursuant to which we lease our European manufacturing sites from LyondellBasell.

Under the terms of the above agreements, either party is permitted to terminate the applicable agreement in a variety of situations. Should LyondellBasell fail to provide these services or should any operating agreement be terminated, we would be forced to obtain these services from third parties or provide them ourselves. Similarly, if in connection with or independent from the termination of an operating agreement, LyondellBasell terminates a facility lease, we would be forced to relocate our manufacturing facility. The failure of LyondellBasell to perform its obligations under, or the termination of, any of these agreements could adversely affect our operations and, depending on market conditions at the time of any such termination, we may not be able to enter into substitute arrangements in a timely manner, or on terms as favorable to us.

From time to time, as part of our ongoing business operations, we discuss potential changes in the terms of our various agreements with LyondellBasell, based upon changes in market conditions or other factors. Any agreed changes to any of these contractual arrangements are not effective until implemented by the parties.

Under certain of these agreements, we are required to indemnify LyondellBasell, including in certain circumstances for loss and damages resulting from LyondellBasell s negligence in performing their obligations.

The failure of our raw materials suppliers to perform their obligations under long-term supply agreements, or our inability to replace or renew these agreements when they expire, could increase our cost for these materials, interrupt production or otherwise adversely affect our results of operations.

Our manufacturing processes use three primary raw materials: styrene, butadiene and isoprene. We use styrene in the production of most of our polymer products. We use butadiene in the production of SBS grades of USBCs and SEBS (styrene-ethylene-butylene-styrene) grades of HSBCs. We use isoprene in the production of

Table of Contents

Index to Financial Statements

SIS (styrene-isoprene-styrene) grades of USBCs, SEPS (styrene-ethylene-propylene-styrene) grades of HSBCs and polyisoprene rubber, or IR. We have entered into long-term supply agreements with Shell Chemicals, LyondellBasell and others to supply our raw material needs in the United States and Europe. As these contracts expire, we may be unable to renew these contracts or obtain new long-term supply agreements on terms favorable to us, which may significantly impact our operations.

In addition, most of our long-term contracts contain provisions that allow our suppliers to limit, or allocate, the amount of raw materials shipped to us below the contracted amount in certain circumstances. If we are required to obtain alternate sources for raw materials because a supplier is unwilling or unable to perform under raw material supply agreements or if a supplier terminates its agreements with us, we may not be able to obtain these raw materials from alternative suppliers in sufficient quantities or in a timely manner, and we may not be able to enter into long-term supply agreements on terms as favorable to us. A lack of availability of raw materials could have an adverse effect on our results of operations.

If the availability of isoprene is limited, we may be unable to produce some of our products in quantities demanded by our customers, which could have an adverse effect on our sales of products requiring isoprene.

Isoprene is not widely available, and the few isoprene producers tend to use their production for captive manufacturing purposes or sell only limited quantities into the world chemicals market. Isoprene is primarily produced and consumed by manufacturers captively for the production of IR, which is primarily used in the manufacture of rubber tires. As a result, there is limited non-captive isoprene available for purchase in the markets in which we operate. Future isoprene requirements for our IR products will be met by our overall isoprene sourcing strategies.

The major producers of isoprene are Goodyear, Shell Chemicals, Nippon Zeon, Braskem, several Chinese producers and various Russian manufacturers. Currently, we source our isoprene requirements for the United States and Europe from a portfolio of suppliers. In Japan, we obtain the majority of our isoprene requirements from our joint venture partner, on a commercial supply basis and from alternative suppliers as needed. In Brazil, isoprene is obtained from a local third party supplier. These suppliers may not be able to meet our isoprene requirements, and we may not be able to obtain isoprene required for our operations on terms favorable to us or at all.

Because there is limited non-captive isoprene availability, the market for isoprene is thin and prices are particularly volatile. Prices for isoprene are impacted by the supply and prices of natural and synthetic rubber, prevailing energy prices and the existing supply and demand of isoprene in the market. Significant increases in the cost of isoprene could have a material impact on our results of operations. In the past, tight supply in the isoprene market has been exacerbated by operational problems of some key producers and reduced availability of crude C5 inputs for the extraction units. A lack of availability of isoprene could have an adverse effect on our results of operations if we are unable to produce products containing isoprene.

If the availability of butadiene is limited, we may be unable to produce some of our products in quantities demanded by our customers, which could have an adverse effect on facility utilization and our sales of products requiring butadiene.

The North American market is structurally short of butadiene and has relied on imports of crude C4 and/or butadiene to balance demand. Due to political unrest in Libya and U.S. sanctions that were imposed upon the Libyan government, crude C4 exports to the United States from Libya were interrupted, and this could affect our ability to obtain butadiene in the United States in the quantities or at the prices we require. Historically, the European market has been better balanced and provided exports to North America. Currently, our butadiene requirements in the United States are satisfied by several suppliers, and LyondellBasell is our major butadiene supplier in Europe. In general, the quantity of butadiene available in any one region is dependent on the cracking

Table of Contents

Index to Financial Statements

inputs of olefins plants, ethylene demand, inter-regional demand for butadiene and demand for other oil derivatives. Suppliers may not be able to meet our butadiene requirements, and we may not be able to obtain substitute supplies of butadiene from alternative suppliers in a timely manner or on favorable terms.

If the availability of styrene is limited, we may be unable to produce some of our products in quantities demanded by our customers, which could have an adverse effect on facility utilization and our sales of products requiring styrene.

We satisfy our styrene requirements in the United States and Europe pursuant to purchase agreements with maturities up to the end of 2013, subject to renewal conditions. We have more than one supplier in each of these regions and also generally have alternatives for either modifying the contract, supply portfolio or obtaining spot supply. As contracts expire, we cannot give assurances that we will obtain new long-term supply agreements or that the terms of any such agreements will be on terms favorable to us, and consequently our future acquisition costs for styrene may therefore increase.

Increases in the costs of our raw materials could have an adverse effect on our financial condition and results of operations if those costs cannot be passed onto our customers.

Our results of operations are directly affected by the cost of our raw materials. Our three principal raw materials (butadiene, styrene, and isoprene) together represented approximately 58.8%, 55.6% and 42.6% of our total cost of goods sold for the years ended December 31, 2011, 2010 and 2009, respectively. In general, increases in energy prices have led to increases in the costs of butadiene and styrene, which would lead to increases in the cost of our raw materials. Butadiene pricing has been particularly volatile in 2011 and 2010. Political unrest in the Middle East and market dislocation resulting from U.S. sanctions relating thereto could lead to increases in the price of crude oil. As described above, the market for non-captive isoprene is thin and prices are particularly volatile. Because of the significant portion of our cost of goods sold represented by these three monomers, our gross profit margins could be adversely affected by changes in the cost of these raw materials if we are unable to pass the increases on to our customers.

Our end use markets are highly competitive, and we may lose market share to other producers of styrenic block copolymers or to producers of other products that can be substituted for our products.

Our industry is highly competitive and we face significant competition from large international producers, as well as from smaller regional competitors. Our competitors may improve their competitive position in our core end use markets by successfully introducing new products, improving their manufacturing processes or expanding their capacity or manufacturing facilities. If we are unable to keep pace with our competitors product and manufacturing process innovations, our financial condition and results of operations could be materially adversely affected.

Our most significant competitors are Asahi Chemical, Chi Mei, Dynasol Elastomers, Kuraray Company, Korea Kumho P.C., Lee Chang Yung, LG Chemical, Polimeri Europa, Sinopec, Taiwan Synthetic Rubber Corporation and Zeon Corporation. Several competitors, including Lee Chang Yung, LG Chemical and Sinopec, have expanded USBC capacity over the last three years.

In addition, competition between styrenic block copolymers and other products within the end use markets in which we compete is intense. Increased competition from existing or newly developed SBC or non-SBC products may reduce demand for our products in the future and our customers may decide on alternate sources to meet their requirements. If we are unable to successfully compete with other producers of styrenic block copolymers or if other products can be successfully substituted for our products, our sales may decline.

Table of Contents

Index to Financial Statements

If we are not able to continue the technological innovation and successful commercial introduction of new products, our customers may turn to other producers to meet their requirements.

Our industry and the end use markets into which we sell our products experience periodic technological change and ongoing product improvements. In addition, our customers may introduce new generations of their own products or require new technological and increased performance specifications that would require us to develop customized products. Innovation or other changes in our customers product performance requirements may also adversely affect the demand for our products. Our future growth will depend on our ability to gauge the direction of the commercial and technological progress in all key end use markets, and upon our ability to successfully develop, manufacture and market products in such changing end use markets. In order to maintain our profit margins and our competitive position, we must continue to identify, develop and market innovative products on a timely basis to replace existing products. We may not be successful in developing new products and technology that successfully compete with newly introduced products and materials, and our customers may not accept, or may have lower demand for, any of our new products. If we fail to keep pace with evolving technological innovations or fail to modify our products in response to our customers needs, then our business, financial condition and results of operations could be adversely affected as a result of reduced sales of our products.

Our business relies on intellectual property and other proprietary information, and our failure to protect our rights could harm our competitive advantages with respect to the manufacturing of some of our products.

Our success depends to a significant degree upon our ability to protect and preserve our intellectual property and other proprietary information relating to our business. However, we may be unable to prevent third parties from using our intellectual property and other proprietary information without our authorization or independently developing intellectual property and other proprietary information that is similar to ours, particularly in those countries where the laws do not protect our proprietary rights to the same degree as in the United States. The use of our intellectual property and other proprietary information by others could reduce or eliminate any competitive advantage we have developed, cause us to lose sales or otherwise harm our business. If it becomes necessary for us to litigate to protect these rights, any proceedings could be burdensome and costly, and we may not prevail.

In addition, we acquired a significant number of patents from Shell Chemicals. Pursuant to the agreements with Shell Chemicals relating to their contribution of these patents to us and our ownership of these patents, Shell Chemicals retained for itself fully-transferable and exclusive licenses to their use outside of the elastomers business, as well as fully-transferable non-exclusive licenses within the field of elastomers for certain limited uses in non-competing activities. Shell Chemicals is permitted to sublicense these rights. Shell Chemicals also retains the right to enforce these patents outside the elastomers field and recover any damages resulting from these actions.

Any patents, issued or applied for, may not provide us with any competitive advantage and may be challenged by third parties. Our competitors also may attempt to design around our patents or copy or otherwise obtain and use our intellectual property and other proprietary information. Moreover, our competitors may already hold or have applied for patents in the United States or abroad that, if enforced or issued, could possibly prevail over our patent rights or otherwise limit our ability to manufacture or sell one or more of our products in the United States or abroad. From time to time, we oppose the issuance of patent applications in the United States and other jurisdictions that we consider overbroad or otherwise invalid in order to maintain the necessary freedom to operate fully in our various business lines without the risk of being sued for patent infringement. In general, competitors or other parties may, from time to time, assert issued patents or other intellectual property rights against us. If we are legally determined, at some future date, to infringe or violate the intellectual property rights of another party, we may have to pay damages, stop the infringing use, or attempt to obtain a license agreement with the owner of such intellectual property. With respect to our pending patent applications, we may not be successful in securing patents for these claims. Our failure to secure these patents may limit our ability to

Table of Contents

Index to Financial Statements

protect inventions that these applications were intended to cover. In addition, the expiration of a patent can result in increased competition with consequent erosion of profit margins.

It is our policy to enter into confidentiality agreements with our employees and third parties to protect our unpatented proprietary manufacturing expertise, continuing technological innovation and other trade secrets, but our confidentiality agreements could be breached or may not provide meaningful protection for our trade secrets or proprietary manufacturing expertise. Adequate remedies may not be available in the event of an unauthorized use or disclosure of our trade secrets and manufacturing expertise. Violations by others of our confidentiality agreements and the loss of employees who have specialized knowledge and expertise could harm our competitive position and cause our sales and operating results to decline as a result of increased competition. In addition, others may obtain knowledge of our trade secrets through independent development or other access by legal means.

The applicable governmental authorities may not approve our pending service mark and trademark applications. A failure to obtain trademark registrations in the United States and in other countries could limit our ability to obtain and retain our trademarks and impede our marketing efforts in those jurisdictions. Moreover, third parties may seek to oppose our applications or otherwise challenge the resulting registrations. In the event that our trademarks are successfully challenged, we could be forced to rebrand our products, which could result in loss of brand recognition and could require us to devote resources to advertising and marketing new brands.

The failure of our patents, trademarks or confidentiality agreements to protect our intellectual property and other proprietary information, including our processes, apparatuses, technology, trade secrets, trade names and proprietary manufacturing expertise, methods and compounds, could have a material adverse effect on our competitive advantages over other producers.

Our products may infringe the intellectual property rights of others, which may cause us to incur unexpected costs or prevent us from selling our products.

Many of our competitors have a substantial amount of intellectual property that we must continually monitor to avoid infringement. We cannot guarantee that our processes and products do not and will not infringe issued patents (whether present or future) or other intellectual property rights belonging to others, including, without limitation, situations in which our products, processes or technologies may be covered by patent applications filed by other parties in the United States or abroad.

From time to time, we oppose patent applications that we consider overbroad or otherwise invalid in order to maintain the necessary freedom to operate fully in our various business lines without the risk of being sued for patent infringement. If, however, patents are subsequently issued on any such applications by other parties, or if patents belonging to others already exist that cover our products, processes or technologies, we could be liable for infringement or have to take other remedial or curative actions to continue our manufacturing and sales activities with respect to one or more products.

We may also be subject to legal proceedings and claims in the ordinary course of our business, including claims of alleged infringement of the patents, trademarks and other intellectual property rights of third parties by us or our licensees in connection with their use of our products. Intellectual property litigation is expensive and time-consuming, regardless of the merits of any claim, and could divert our management s attention from operating our business.

If we were to discover that our processes, technologies or products infringe the valid intellectual property rights of others, we might need to obtain licenses from these parties or substantially re-engineer our products in order to avoid infringement. We may not be able to obtain the necessary licenses on acceptable terms, or at all, or be able to re-engineer our products successfully. Moreover, if we are sued for infringement and lose, we could be required to pay substantial damages and/or be enjoined from using or selling the infringing products or technology. If we incur significant costs to litigate our intellectual property rights or on fees to obtain licenses, or if our inability to obtain required licenses for our processes, technologies or products prevents us from selling our products , then our business and results of operations could be materially adversely affected.

Table of Contents

Index to Financial Statements

Our business is subject to seasonality that may affect our quarterly operating results and impact the market price of our common stock.

Seasonal changes and weather conditions typically affect our Paving and Roofing end use market. In particular, sales volumes for paving products generally rise in the warmer months and generally decline during the colder months of fall and winter. Roofing product sales volumes tend to be more consistent throughout the year. In addition, abnormally cold or wet seasons may cause reduced purchases from our Paving and Roofing customers. However, because seasonal weather patterns are difficult to predict, we cannot accurately estimate fluctuations in our quarterly Paving and Roofing sales in any given year. If Paving and Roofing results cause our operating results to fall below the periodic expectations of financial analysts or investors, the market price of our common stock may decline.

Substantial indebtedness could adversely affect our financial condition and prevent us from fulfilling our obligations under the senior secured credit facility and the senior notes.

As of December 31, 2011, our indebtedness consists of:

- $142.5 million senior secured term loan under our senior secured credit facility; and
- $250.0 million principal amount of senior unsecured notes.

As of December 31, 2011 we have borrowing capacity available to us of $200 million under the revolving portion of the senior secured credit facility, which, if borrowed, would be senior secured indebtedness and subject to our compliance with certain covenants and other conditions. Additionally we have the option to raise up to $125 million of incremental term loans or increased revolving credit commitments without satisfying any additional financial tests under the indentures governing the senior notes, which, if borrowed, would be senior secured indebtedness.

Although the terms of our senior secured credit facility and the indenture governing the senior notes contain restrictions on the incurrence of additional indebtedness, these restrictions are subject to a number of important exceptions, and indebtedness incurred in compliance with these restrictions could be substantial. If we and our restricted subsidiaries incur significant additional indebtedness, the related risks that we face could increase.

Our indebtedness could:

- make it more difficult for us to satisfy our financial obligations;
- increase our vulnerability to adverse economic and industry conditions;
- increase the risk that we breach financial covenants and other restrictions in our debt agreements;
- require us to dedicate a substantial portion of our cash flow from operations to make payments on our indebtedness, thereby reducing the availability of our cash flow to fund working capital, capital expenditures and other general corporate purposes;
- limit our flexibility in planning for, or reacting to, changes in the business and industry in which we operate;

restrict us from exploiting business opportunities;

place us at a disadvantage compared to our competitors that have less debt and lease obligations; and

limit our ability to borrow additional funds for working capital, capital expenditures, acquisitions, debt service requirements, execution of our business strategy and other general corporate purposes or to refinance our existing debt.

Our ability to pay principal of and interest on indebtedness, fund working capital, and make anticipated capital expenditures depends on our future performance, which is subject to general economic conditions and other factors, some of which are beyond our control. There can be no assurance that our business will generate sufficient cash flow from operations or that future borrowings will be available under the senior secured revolving credit facility to fund

Table of Contents

Index to Financial Statements

liquidity needs, including debt service. Furthermore, if we decide to undertake additional investments in existing or new facilities, this will likely require additional capital, and there can be no assurance that this capital will be available.

Our debt instruments, including the senior secured credit facility and the indenture governing the senior notes, impose significant operating and financial restrictions on us.

Our senior secured credit facility and the indenture governing our senior notes contain, and any future indebtedness may contain, a number of restrictive covenants that impose significant operating and financial restrictions on us. Under the terms of our senior secured credit facility, we are subject to financial covenants, including maintenance of a maximum consolidated net leverage ratio, a minimum consolidated net interest coverage ratio and maximum capital expenditures. In addition, our credit facility and indenture include restrictions on our ability to, among other things:

- place liens on our or our subsidiaries assets;
- make investments other than permitted investments;
- incur additional indebtedness;
- merge, consolidate or dissolve;
- sell assets;
- engage in transactions with affiliates;
- change the nature of our business;
- change our or our subsidiaries fiscal year or organizational documents; and
- make restricted payments (including certain equity issuances).

A failure by us or our subsidiaries to comply with the covenants or to maintain the required financial ratios contained in the agreements governing our indebtedness could result in an event of default under such indebtedness, which could adversely affect our ability to respond to changes in our business and manage our operations. Upon the occurrence of an event of default under any of the agreements governing our indebtedness, the lenders could elect to declare all amounts outstanding to be due and payable and exercise other remedies as set forth in the agreements. Further, an event of default or acceleration of indebtedness under one instrument may constitute an event of default under another instrument. If any of our indebtedness were to be accelerated, there can be no assurance that our assets would be sufficient to repay this indebtedness in full, which could have a material adverse effect on our ability to continue to operate as a going concern.

Chemical manufacturing is inherently hazardous, which could result in accidents that disrupt our operations or expose us to significant losses or liabilities.

Hazards associated with chemical manufacturing and the related storage and transportation of raw materials, products and wastes exist in our operations and the operations of other occupants with whom we share manufacturing sites. These hazards could lead to an interruption or suspension of operations and have an adverse effect on the productivity and profitability of a particular manufacturing facility or on us as a whole. These potential risks include, but are not necessarily limited to:

pipeline and storage tank leaks and ruptures;

explosions and fires;

inclement weather and natural disasters;

terrorist attacks;

mechanical failure; and

chemical spills and other discharges or releases of toxic or hazardous substances or gases.

Table of Contents

Index to Financial Statements

These hazards may result in personal injury and loss of life, damage to property and contamination of the environment, which may result in a suspension of operations and the imposition of civil or criminal penalties, including governmental fines, expenses for remediation and claims brought by governmental entities or third parties. The loss or shutdown of operations over an extended period at our Belpre facility, which is our largest manufacturing facility, or any of our other major operating facilities could have a material adverse effect on our financial condition and results of operations. Our property, business interruption and casualty insurance may not fully insure us against all potential hazards incidental to our business.

We may be liable for damages based on product liability claims brought against our customers in our end use markets.

Many of our products provide critical performance attributes to our customers products that are sold to consumers who could potentially bring product liability suits in which we could be named as a defendant. The sale of these products entails the risk of product liability claims. If a person were to bring a product liability suit against one of our customers, the customer may attempt to seek contribution from us. A person may also bring a product liability claim directly against us. A successful product liability claim or series of claims against us in excess of our insurance coverage for payments, for which we are not otherwise indemnified, could have a material adverse effect on our financial condition or results of operations. There can be no assurance that our efforts to protect ourselves from product liability claims in this regard will ultimately protect us from any such claims.

As a global business, we are exposed to local business risks in different countries, which could have a material adverse effect on our financial condition or results of operations.

We have significant operations in foreign countries, including manufacturing facilities, research and development facilities, sales personnel and customer support operations. Currently, we operate, or others operate on our behalf, facilities in Brazil, Germany, France and Japan, in addition to our operations in the United States. We are also in negotiations to enter into a joint venture in Taiwan. Our foreign operations are subject to risks inherent in doing business in foreign countries, including, but not necessarily limited to:

- new and different legal and regulatory requirements in local jurisdictions;
- export duties or import quotas;
- domestic and foreign customs and tariffs or other trade barriers;
- potential staffing difficulties and labor disputes;
- risk of non-compliance with the United States Foreign Corrupt Practices Act or similar antibribery legislation in other countries by agents or other third-party representatives;
- managing and obtaining support and distribution for local operations;
- increased costs of transportation or shipping;
- credit risk and financial conditions of local customers and distributors;

potential difficulties in protecting intellectual property;

risk of nationalization of private enterprises by foreign governments;

potential imposition of restrictions on investments;

potentially adverse tax consequences, including imposition or increase of withholding and other taxes on remittances and other payments by subsidiaries;

foreign currency exchange restrictions and fluctuations;

local political and social conditions, including the possibility of hyperinflationary conditions and political instability in certain countries; and

civil unrest, including labor unrest, in response to local political conditions.

Table of Contents

Index to Financial Statements

We may not be successful in developing and implementing policies and strategies to address the foregoing risks in a timely and effective manner at each location where we do business. Consequently, the occurrence of one or more of the foregoing risks could have a material adverse effect on our international operations or upon our financial condition and results of operations.

Compliance with extensive environmental, health and safety laws could require material expenditures, changes in our operations or site remediation.

Materials such as styrene, butadiene and isoprene, which are used in the manufacture of our products, can represent potentially significant health and safety concerns. Our products are also used in a variety of end uses that have specific regulatory requirements such as those relating to products that have contact with food or medical end uses.

We use large quantities of hazardous substances and generate hazardous wastes in our manufacturing operations. Consequently, our operations are subject to extensive environmental, health and safety laws and regulations at both the national and local level in multiple jurisdictions. These laws and regulations govern, among other things, air emissions, wastewater discharges, solid and hazardous waste management, site remediation programs and chemical use and management. Many of these laws and regulations have become more stringent over time and the costs of compliance with these requirements may increase, including costs associated with any necessary capital investments. In addition, our production facilities require operating permits that are subject to renewal and, in some circumstances, revocation. The necessary permits may not be issued or continue in effect, and any issued permits may contain significant new requirements. The nature of the chemical industry exposes us to risks of liability due to the use, production, management, storage, transportation and sale of materials that are heavily regulated or hazardous and can cause contamination or personal injury or damage if released into the environment.

Because of the nature of our operations, we could be subject to legislation and regulation affecting the emission of greenhouse gases. The EPA has promulgated new regulations applicable to projects involving greenhouse gas emissions above a certain threshold, and the U.S. and certain states within the U.S. have enacted, or are considering, limitations on greenhouse gas emissions. These requirements to limit greenhouse gas emissions may require us to incur capital investments to upgrade our operations to comply with any future greenhouse gas emissions controls. While the impact of any such legislation or regulation is currently speculative, any such legislation or regulation, if enacted, may have an adverse effect on our operations or financial condition.

Compliance with environmental laws and regulations generally increases the costs of transportation and storage of raw materials and finished products, as well as the costs of storage and disposal of wastes. We may incur substantial costs, including fines, damages, criminal or civil sanctions and remediation costs, or experience interruptions in our operations for violations arising under environmental laws, regulations or permit requirements.

Regulation of our employees exposure to butadiene could require material expenditures or changes in our operations.

Butadiene is a known carcinogen in laboratory animals at high doses and is being studied for its potential adverse health effects. The Occupational Safety and Health Administration limits the permissible employee exposure to butadiene. Future studies on the health effects of butadiene may result in additional regulations or new regulations in Europe that further restrict or prohibit the use of, and exposure to, butadiene. Additional regulation of butadiene could require us to change our operations, and these changes could affect the quality of our products and materially increase our costs.

Table of Contents

Index to Financial Statements

We may be subject to losses due to lawsuits arising out of environmental damage or personal injuries associated with chemical manufacturing.

We face the risk that individuals could, in the future, seek damages for personal injury due to exposure to chemicals at our facilities or to chemicals otherwise owned or controlled by us. We may be subject to future claims with respect to workplace exposure, workers compensation and other matters that are filed after the date of our acquisition of Shell Chemicals elastomers business. While Shell Chemicals has agreed to indemnify us for certain claims brought with respect to matters occurring before our separation from Shell Chemicals in February 2001, those indemnity obligations are subject to limitations, and we cannot be certain that those indemnities will be sufficient to satisfy claims against us. In addition, we face the risk that future claims would fall outside of the scope of the indemnity due either to the limitations on the indemnity or to their arising from events and circumstances occurring after February 2001. Finally, under certain of the lease and operating agreements under which LyondellBasell leases and provides services to our sites in Wesseling, Germany, and Berre, France, we are required to indemnify LyondellBasell in certain circumstances, including in certain circumstances for loss and damages resulting from LyondellBasell s negligence in performing their obligations.

Some environmental laws could impose on us the entire cost of clean-up of contamination present at a facility even though we did not cause the contamination. These laws often identify the site owner as one of the parties that can be jointly and severally liable for on-site remediation, regardless of fault or whether the original activity was legal at the time it occurred. For example, our Belpre, Ohio, facility is the subject of a required remediation program to clean up past contamination at the site and at an adjacent creek and we are a party to that site clean-up order. While Shell Chemicals has posted financial assurance of $5.2 million for this program and has taken the lead in implementing the program, we may incur costs and be required to take action under this program. Similarly, the Shell Chemicals indemnity for remediation at the Belpre facility may not cover all claims that might be brought against us.

Our Paulinia, Brazil, facility also has on-site contamination resulting from past operations of Shell Chemicals. Although an indemnity from Shell Chemicals covers claims related to specified areas within the facility, we may be required to undertake and pay for remediation of these and other areas. The indemnity coverage from Shell Chemicals is limited in time and amount and we cannot rely upon it to cover possible future claims for on-site contamination separate from the areas specified in the indemnity. The Paulinia facility is also adjacent to a former Shell Chemicals site where we believe past manufacturing of hydrocarbons resulted in significant contamination of soil and groundwater and required relocation of nearby residents. It is our understanding that the Shell Chemicals portion of the site has changed ownership several times, which may impact financial responsibility for contamination on the site. While we are not aware of any significant contamination at our Paulinia facility, we could potentially be the subject of claims related to pesticide contamination and effects at some point in the future.

In general, there is always the possibility that a third-party plaintiff or claimant, or governmental or regulatory authority, could seek to include us in an action or claim for damages, clean-up, or remediation pertaining to events or circumstances occurring or existing at one or more of our sites prior to the time of our ownership or occupation of the applicable site. In the event that any of these actions or claims were asserted against us, our results of operations could be adversely affected.

Regulatory and statutory changes applicable to us or our customers could adversely affect our financial condition and results of operations.

We and many of the applications for the products in the end use markets in which we sell our products are regulated by various national and local rules, laws and regulations. Changes in any of these areas could result in additional compliance costs, seizures, confiscations, recall or monetary fines, any of which could prevent or inhibit the development, distribution and sale of our products. For example, changes in environmental regulations restricting the use of disposable diapers could cause a decline in sales to producers of that product. In addition, we benefit from certain trade protections, including anti-dumping protection. If we were to lose these protections, our results of operations could be adversely affected.

Table of Contents

Index to Financial Statements

We are subject to customs, international trade, export control, antitrust, zoning and occupancy and labor and employment laws that could require us to modify our current business practices and incur increased costs.

We are subject to numerous regulations, including customs and international trade laws, export control, antitrust laws and zoning and occupancy laws that regulate manufacturers generally and/or govern the importation, promotion and sale of our products, the operation of factories and warehouse facilities and our relationship with our customers, suppliers and competitors. If these regulations were to change or were violated by our management, employees, suppliers, buying agents or trading companies, the costs of certain goods could increase, or we could experience delays in shipments of our goods, be subject to fines or penalties, or suffer reputational harm, which could reduce demand for our products and hurt our business and negatively impact our results of operations. In addition, changes in federal and state minimum wage laws and other laws relating to employee benefits could cause us to incur additional wage and benefits costs, which could negatively impact our profitability.

Legal requirements are frequently changed and subject to interpretation, and we are unable to predict the ultimate cost of compliance with these requirements or their effects on our operations. We may be required to make significant expenditures or modify our business practices to comply with existing or future laws and regulations, which may increase our costs and materially limit our ability to operate our business.

Fluctuations in currency exchange rates may significantly impact our results of operations and may significantly affect the comparability of our results between financial periods.

Our operations are conducted by subsidiaries in many countries. The results of the operations and the financial position of these subsidiaries are reported in the relevant foreign currencies and then translated into U.S. dollars at the applicable exchange rates for inclusion in our consolidated financial statements. The main currencies, to which we are exposed, besides the U.S. dollar, are the Euro, Japanese Yen and Brazilian Real. The exchange rates between these currencies and the U.S. dollar in recent years have fluctuated significantly and may continue to do so in the future. A depreciation of these currencies against the U.S. dollar will decrease the U.S. dollar equivalent of the amounts derived from these operations reported in our consolidated financial statements and an appreciation of these currencies will result in a corresponding increase in such amounts. Because many of our raw material costs are determined with respect to the U.S. dollar rather than these currencies, depreciation of these currencies may have an adverse effect on our profit margins or our reported results of operations. Conversely, to the extent that we are required to pay for goods or services in foreign currencies, the appreciation of such currencies against the U.S. dollar will tend to negatively impact our results of operations. In addition, currency fluctuations may affect the comparability of our results of operations between financial periods.

We incur currency transaction risk whenever we enter into either a purchase or sale transaction using a currency other than the local currency of the transacting entity. We employ hedging strategies to minimize our exposure to certain foreign currency fluctuations. Given the volatility of exchange rates, there can be no assurance that we will be able to effectively manage our currency transaction risks, that our hedging activities will be effective or that any volatility in currency exchange rates will not have a material adverse effect on our financial condition or results of operations.

Our planned joint venture in Asia is subject to risks and uncertainties.

We are currently negotiating definitive documentation with Formosa Petrochemical Corporation to construct and operate a 30 kiloton HSBC facility to be located in Mailiao, Taiwan. We cannot be certain that we will be able to acquire all necessary permitting or other approvals for the construction of the facility in a timely fashion, if at all, or be able to reach definitive agreements regarding this joint venture or, if definitive agreements are reached, that the facility will be successfully constructed and operated within our expected timeframe or budget or yield expected results. If any of these risks materialize, our prospects in Asia could be materially delayed or adversely impacted.

Table of Contents

Index to Financial Statements

Our relationship with our employees could deteriorate, which could adversely affect our operations.

As a manufacturing company, we rely on our employees and good relations with our employees to produce our products and maintain our production processes and productivity. As of December 31, 2011, we had 916 full-time employees. A significant number of our non-U.S. employees are subject to arrangements similar to collective bargaining arrangements. With respect to these employees, we may not be able to negotiate labor agreements on satisfactory terms, and actions by our employees may disrupt our business. If these workers were to engage in a strike, work stoppage or other slowdown, our operations could be disrupted or we could experience higher labor costs. In addition, if our other employees were to become unionized, in particular our employees at our Belpre, Ohio, facility, we could experience significant operating disruptions and higher ongoing labor costs, which could adversely affect our business and financial condition and results of operations. Because many of the personnel who operate our European facilities are employees of LyondellBasell, relations between LyondellBasell and its employees may also adversely affect our business and financial condition and results of operations.

Loss of key personnel or our inability to attract and retain new qualified personnel could hurt our business and inhibit our ability to operate and grow successfully.

Our success in the highly competitive markets in which we operate will continue to depend to a significant extent on our key employees. We are dependent on the expertise of our executive officers. Loss of the services of any of our executive officers could have an adverse effect on our prospects. We may not be able to retain our key employees or to recruit qualified individuals to join our company. The loss of key employees could result in high transition costs and could disrupt our operations.

We generally do not have long-term contracts with our customers, and the loss of customers could adversely affect our sales and profitability.

With some exceptions, our business is based primarily upon individual sales orders with our customers. As such, our customers could cease buying our products from us at any time, for any reason, with little or no recourse. If multiple customers elected not to purchase products from us, our business prospects, financial condition and results of operations could be adversely affected.

A decrease in the fair value of pension assets could materially increase future funding requirements of the pension plan.

We sponsor a defined benefit pension plan. The total projected benefit obligation of our defined benefit pension plan exceeded the fair value of the plan assets by approximately $44.8 million at December 31, 2011. We contributed $7.4 million to the pension plan in 2011 and, based on the actuarial and other assumptions used in our consolidated financial statements, are forecasting contributions of approximately $9.8 million in 2012. Among the key assumptions inherent in the actuarially calculated pension plan obligation and pension plan expense are the discount rate and the expected rate of return on plan assets. If interest rates and actual rates of return on invested plan assets were to decrease significantly, the pension plan obligation could increase materially. The size of future required pension contributions could result in our dedicating a substantial portion of our cash flow from operations to making the contributions, which could materially adversely affect our business, financial condition and results of operations.

Delaware law and some provisions of our organizational documents make a takeover of our company more difficult.

Provisions of our charter and bylaws may have the effect of delaying, deferring or preventing a change in control of our company. A change of control could be proposed in the form of a tender offer or takeover proposal that might result in a premium over the market price for our common stock. In addition, these provisions could

Table of Contents

Index to Financial Statements

make it more difficult to bring about a change in the composition of our board of directors, which could result in entrenchment of current management. For example, our charter and bylaws:

- establish a classified board of directors so that not all members of our board of directors are elected at one time;
- require that the number of directors be determined, and provide that any vacancy or new board seat may be filled, only by the board;
- do not permit stockholders to act by written consent;
- do not permit stockholders to call a special meeting;
- permit the bylaws to be amended by a majority of the board without shareholder approval, and require that a bylaw amendment proposed by stockholders be approved by two-thirds of all outstanding shares;
- establish advance notice requirements for nominations for elections to our board of directors or for proposing matters that can be acted upon by stockholders at stockholder meetings; and
- authorize the issuance of undesignated preferred stock, or blank check preferred stock, by our board of directors without shareholder approval.

Our Kraton Performance Polymers, Inc. Executive Severance Program and the equity arrangements with our executive officers also contain change in control provisions. Under the terms of these arrangements, the executive officers are entitled to receive significant cash payments, immediate vesting of options, restricted shares and notional shares, and continued medical benefits in the event their employment is terminated under certain circumstances within one year following a change in control, and with respect to certain equity awards, within two years following a change in control.

Any Supplemental Pension Benefits a participant may have accrued under the Kraton Polymers U.S. LLC Pension Benefit Restoration Plan also vests immediately on a change of control and any amounts accrued under the Kraton Polymers LLC Executive Deferred Compensation Plan are immediately payable upon a change of control. We disclose in proxy statements filed with the SEC potential payments to our named executive officers in connection with a change of control. Further, certain change of control transactions constitute an event of default under our credit facility and would require us to offer to purchase our outstanding senior notes at 101% of their principal amount.

These arrangements and provisions of our organizational documents and Delaware law may have the effect of delaying, deferring or preventing changes of control or changes in management of our company, even if such transactions or changes would have significant benefits for our stockholders. As a result, these provisions could limit the price some investors might be willing to pay in the future for shares of our common stock.

We do not expect to pay any dividends for the foreseeable future.

We do not anticipate paying any dividends to our stockholders for the foreseeable future. The senior secured credit facility and our senior notes indenture may preclude us from paying cash dividends, and we may be subject to other restrictions on our ability to pay dividends from time to time. In addition, because we are a holding company, our ability to pay dividends depends on our receipt of cash dividends and distributions from our subsidiaries. Accordingly, investors must be prepared to rely on sales of their common stock after price appreciation to earn an investment return, which may never occur. Investors seeking cash dividends should not purchase our common stock. Any determination to pay dividends in the future will be made at the discretion of our board of directors and will depend upon our results of operations, financial

conditions, contractual restrictions, restrictions imposed by applicable law or the SEC and other factors our board deems relevant.

Table of Contents

Index to Financial Statements

We are a holding company with nominal net worth and will depend on dividends and distributions from our subsidiaries to pay any dividends.

Kraton Performance Polymers is a holding company with nominal net worth. We do not have any assets or conduct any business operations other than our investments in our subsidiaries, including Kraton Polymers LLC. As a result, our ability to pay dividends, if any, will be dependent upon cash dividends and distributions or other transfers from our subsidiaries. Payments to us by our subsidiaries will be contingent upon their respective earnings and subject to any limitations on the ability of such entities to make payments or other distributions to us. In addition, our subsidiaries are separate and distinct legal entities and have no obligation to make any funds available to us.

Item 1B. Unresolved Staff Comments.

None.

Item 2. Properties.

Our principal executive offices are located at 15710 John F. Kennedy Boulevard, Suite 300, Houston, Texas 77032.

We believe that our properties and equipment are generally in good operating condition and are adequate for our present needs. Production capacity at our sites can vary greatly depending upon feedstock, product mix and operating conditions.

Our properties consist primarily of manufacturing and research and development facilities for the production of specialty chemicals. The following table sets forth our principal facilities:

Location	Acres	Approximate Square Footage	Use	Owned/Leased
Belpre, Ohio	350	3,600,000	Manufacturing	Owned(1)
Wesseling, Germany	8.1	354,000	Manufacturing	Owned(2)
Berre, France	9.0	392,000	Manufacturing	Owned(2)
Paulinia, Brazil	179	2,220,000	Manufacturing	Owned
Kashima, Japan	11.6	395,000	Manufacturing	Owned(3)
Houston, Texas	N/A	105,500	R&D	Leased(4)
Shanghai, China	N/A	33,000	R&D	Leased(4)
Amsterdam, the Netherlands	N/A	32,015	R&D	Leased(4)
Tsukuba, Japan	4.5	23,327	R&D	Leased(4)

(1) A portion of the HSBC capacity at the Belpre facility is owned by Infineum USA, a joint venture between Shell Chemicals and ExxonMobil.
(2) We lease the land, but own the manufacturing facility and production equipment.
(3) The Kashima, Japan, facility is owned by our 50%-50% joint venture with JSR.
(4) We lease the facility, but own the equipment.

Belpre, Ohio. Our Belpre site is our largest manufacturing facility, with connections to barge, rail and truck shipping and receiving facilities. The Belpre site has approximately 192 kilotons of production capacity to which we are entitled. The Belpre facility currently produces USBC,

HSBC, and Cariflex™ products. A portion of the HSBC capacity at Belpre is owned by Infineum USA. Infineum is a joint venture between Shell Chemicals and ExxonMobil that makes products for the lubricant additives business. Under a facility sharing agreement that terminates in 2030, we operate Infineum s share of the HSBC assets to manufacture a line of products for Infineum, and Infineum is entitled to a portion of the HSBC capacity at Belpre. Other than those assets owned by Infineum, we own the Belpre facility and the land on which it is located.

Table of Contents

Index to Financial Statements

Wesseling, Germany. Our Wesseling manufacturing site is located on the premises of LyondellBasell. The site has direct access to major highways and extensive railway connections. Production capacity is approximately 96 kilotons. LyondellBasell owns the land on the premises and leases it to us. The lease is for a term of 30 years, beginning from March 31, 2000 and is extended automatically for a successive period of 10 years unless terminated upon one-year s written notice by either party. We own the SBC manufacturing facility and production equipment in the facility. The Wesseling facility currently produces USBC products. LyondellBasell provides us operating and site services, utilities, materials and facilities under a long-term production agreement. LyondellBasell has the right to approve any expansion of our facility at Wesseling although its consent may only be withheld if an expansion would be detrimental to the site.

Berre, France. Our Berre site is located in southeastern France. The facility has direct access to sea, rail and road transport and has a production capacity of approximately 87 kilotons. The Berre site is leased to us by LyondellBasell, which operates the site and with which our lease exists under a long-term lease due to expire in 2030. We own the SBC manufacturing facility and production equipment at Berre. We currently produce USBC and HSBC products there. We have an operating agreement with LyondellBasell for various site services, utilities and facilities under a long-term agreement.

Paulinia, Brazil. Our Paulinia site is located with access to major highways. The facility currently has a production capacity of approximately 29 kilotons of USBC in addition to capacity dedicated to producing Cariflex™ products. We own the facility and the land at Paulinia. BASF owns the adjacent site and shares title to the facilities that are common to the two companies such as the administration building, cafeteria and maintenance facilities.

Kashima, Japan. Our Kashima site is owned and operated by a manufacturing joint venture named Kraton JSR Elastomers K.K., or KJE, between us and JSR. The Kashima site is located northeast of Tokyo on the main island of Honshu at a JSR site that includes several synthetic rubber plants and butadiene and isoprene extraction units. This site is serviced by rail, barge and truck connections. Production capacity is approximately 42 kilotons of USBC products, and we are generally entitled to 50% of this production pursuant to our joint venture agreement. The SBC manufacturing facility is leased to KJE.

JSR markets its portion of the production under its own trademarks, and we market our portion of the production under the Kraton® brand name although this amount may vary from time to time based on the economic interest of the joint venture. We and JSR each have a right of first refusal on the transfer of the joint venture interests of the other.

Research, Development and Technical Service Facilities. Our research and development activities are primarily conducted in laboratories in Houston, Texas, and Amsterdam, the Netherlands. We support our customers via a technical service network of laboratories around the globe. Our technical service laboratories are located in Shanghai, China, Tsukuba, Japan, and Paulina, Brazil. In addition we have a technical service office in Mont St. Guibert, Belgium.

We perform application development and technical service support in all locations. In addition, our research and development centers in Houston and Amsterdam carry out polymer and process development. We are operating pilot lines in our Houston facility to provide scale up support to our manufacturing sites as well as our customers.

Item 3. Legal Proceedings.

Kraton and LyondellBasell have negotiated and concluded the terms of an agreed arbitration proceeding (to take place in London, England) to determine the ongoing effect of a multi-year term sheet that had been reached between the parties and put into effect in January 2009, covering certain terms and conditions applicable to operations and butadiene sales by LyondellBasell (for and to Kraton) at Berre, France, and Wesseling, Germany.

Table of Contents

Index to Financial Statements

The parties had been dealing with one another in accordance with the term sheet from January 2009 until LyondellBasell notified Kraton on September 9, 2010 that LyondellBasell would no longer follow the term sheet. Since receiving the September 9, 2010 notice, Kraton has been paying an increased net amount to LyondellBasell on a monthly basis (under protest) to reflect the pre-term sheet circumstances between the parties.

The outcome of the arbitration cannot be predicted with accuracy at this time. However, we do not believe it is probable that LyondellBasell will prevail in the arbitration, and we do not expect the final resolution of this matter to have a material impact on our financial position, results of operations or cash flows. For the year ended December 31, 2011, we recognized a charge of $5.7 million, on a pre-tax basis, to cost of goods sold for the net excess payments to LyondellBasell.

In 2011, we were notified by the tax authorities in France that we owed an additional 6.9 million related to the 2009 tax year. The tax authorities claim that we did not timely file forms that serve to cap taxes for 2009. We believe that all such forms were timely filed and we are otherwise in compliance with all filing requirements, and we are owed a refund of 0.3 million. While the outcome of this proceeding cannot be predicted with certainty, we do not expect this matter to have a material adverse effect upon our financial position, results of operations or cash flows.

We and certain of our subsidiaries, from time to time, are parties to various other legal proceedings, claims and disputes that have arisen in the ordinary course of business. These claims may involve significant amounts, some of which would not be covered by insurance. While the outcome of these proceedings cannot be predicted with certainty, our management does not expect any of these other existing matters, individually or in the aggregate, to have a material adverse effect upon our financial position, results of operations or cash flows. Furthermore, Shell Chemicals has agreed, subject to certain limitations, to indemnify us for certain claims brought with respect to matters occurring before February 28, 2001. As of the date of this Form 10-K, we have not been named as parties in any of these claims. Our right to indemnification from Shell Chemicals is subject to certain time limitations. A substantial settlement payment or judgment in excess of our accruals could have a material adverse effect on our financial position, results of operations or cash flows.

For information regarding legal proceedings, including environmental matters, see *Part I, Item 1. Business Environmental Regulation* and Note 11 *Commitments and Contingencies* (subsections (b) and (d) of which are incorporated herein by reference) to the consolidated financial statements for further discussion.

Item 4. Mine Safety Disclosures.

Not applicable.

Table of Contents

Index to Financial Statements

PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Our common stock has been listed on the New York Stock Exchange (NYSE) under the symbol KRA since December 17, 2009. Prior to that date, our equity securities were not listed on any exchange in each period indicated or traded on any public trading market. The following table sets forth the high and low intraday sales prices of our common stock per share, as reported by the New York Stock Exchange.

	Stock Price Range	
	High	Low
2011		
Fourth Quarter	$ 21.85	$ 14.37
Third Quarter	$ 41.84	$ 15.26
Second Quarter	$ 47.89	$ 34.51
First Quarter	$ 41.75	$ 30.03
2010		
Fourth Quarter	$ 34.85	$ 24.62
Third Quarter	$ 30.00	$ 18.28
Second Quarter	$ 21.56	$ 17.57
First Quarter	$ 18.49	$ 12.91

We have not previously declared or paid any dividends or distributions on our common stock. As of February 24, 2012, we had approximately 94 shareholders of record of our common stock and approximately 12,000 beneficial owners.

Table of Contents

Index to Financial Statements

Stock Performance Graph

The following graph reflects the comparative changes in the value from December 17, 2009, the first trading day of our common stock on the NYSE, through December 31, 2011, assuming an initial investment of $100 and the reinvestment of dividends, if any, in (1) our common stock, (2) the S&P SmallCap 600 Index, and (3) the Dow Jones U.S. Specialty Chemicals Index. The information under this caption is not deemed to be soliciting material or to be filed with the SEC or subject to Regulation 14A or 14C under the Securities Exchange Act of 1934 or to the liabilities of Section 18 of the Securities Exchange Act of 1934, and will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent we specifically incorporate it by reference into such a filing. Historical performance should not be considered indicative of future stockholder returns.

Total Return To Shareholders

(Includes reinvestment of dividends)

	Annual Return Percentage, Years Ending		
Company Name / Index	**12/31/09**	**12/31/10**	**12/31/11**
Kraton Performance Polymers, Inc.	0.37%	128.24%	(34.41)%
S&P SmallCap 600 Index	3.68%	26.31%	1.02%
Dow Jones U.S. Specialty Chemicals	1.04%	37.19%	(2.82)%

	Cumulative Value of $100 Investment, through December 31, 2011			
	Base Period			
Company Name / Index	**12/17/09**	**12/31/09**	**12/31/10**	**12/31/11**
Kraton Performance Polymers, Inc.	$ 100.00	$ 100.37	$ 229.09	$ 150.26
S&P SmallCap 600 Index	$ 100.00	$ 103.68	$ 130.95	$ 132.28
Dow Jones U.S. Specialty Chemicals	$ 100.00	$ 101.04	$ 138.62	$ 134.70

Table of Contents

Index to Financial Statements

Dividends

We have not previously declared or paid any dividends or distributions on our common stock. We currently intend to retain all available funds and any future earnings to fund the development and growth of our business, and we do not anticipate paying any cash dividends in the foreseeable future. We are currently restricted in our ability to pay cash dividends on our common stock by the covenants in the senior secured credit facility and may be further restricted by the terms of any of our future debt or preferred securities. In addition, because we are a holding company, our ability to pay dividends depends on our receipt of cash dividends and distributions from our subsidiaries. The terms of our senior notes also restrict our ability and the ability of our subsidiaries to pay dividends. For more information about these restrictions, see Note 7 *Long-Term Debt* to the consolidated financial statements.

Any future determination to pay dividends will be at the discretion of our board of directors and will depend on our financial condition, results of operations, capital expenditure requirements, restrictions contained in current and future financing instruments and other factors that our board of directors deems relevant.

Kraton Polymers LLC Debt Refinancing

On February 11, 2011, we refinanced our existing indebtedness by completing an offering of $250.0 million in aggregate principal amount of 6.75% senior notes due 2019 through an institutional private placement and entering into a $350.0 million senior secured credit agreement with a maturity date of February 11, 2016. The terms of our senior notes restricts our ability and the ability of our subsidiaries to pay dividends. See Note 7 *Long-Term Debt* to the consolidated financial statements for further discussion.

Table of Contents

Index to Financial Statements

Item 6. Selected Financial Data.

The selected financial data below should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations included under Item 7 of this Form 10-K as well as the consolidated financial statements and the related notes.

	Years ended December 31,				
	2011	2010	2009	2008	2007
	(in thousands, except per share data)				
Consolidated statements of operations data:					
Operating revenues:					
Sales	$ 1,437,479	$ 1,228,425	$ 920,362	$ 1,171,253	$ 1,066,044
Other(1)	0	0	47,642	54,780	23,543
Total operating revenues	1,437,479	1,228,425	968,004	1,226,033	1,089,587
Cost of goods sold	1,121,293	927,932	792,472	971,283	938,556
Gross profit	316,186	300,493	175,532	254,750	151,031
Operating expenses					
Research and development	27,996	23,628	21,212	27,049	24,865
Selling, general and administrative	101,606	92,305	79,504	101,431	69,020
Depreciation and amortization	62,735	49,220	66,751	53,162	51,917
Total operating expenses	192,337	165,153	167,467	181,642	145,802
Gain (loss) on extinguishment of debt	(2,985)	0	23,831	0	0
Earnings of unconsolidated joint venture(2)	529	487	403	437	626
Interest expense, net	29,884	23,969	33,956	36,695	43,484
Income (loss) before income taxes	91,509	111,858	(1,657)	36,850	(37,629)
Income tax expense (benefit)	584	15,133	(1,367)	8,431	6,120
Net income (loss)	$ 90,925	$ 96,725	$ (290)	$ 28,419	$ (43,749)
Earnings (loss) per common share					
Basic	$ 2.85	$ 3.13	$ (0.01)	$ 1.46	$ (2.26)
Diluted	$ 2.81	$ 3.07	$ (0.01)	$ 1.46	$ (2.26)
Weighted average common shares outstanding					
Basic	31,786	30,825	19,808	19,387	19,375
Diluted	32,209	31,379	19,808	19,464	19,375

(1) Other revenues include the sale of by-products generated in the production of IR and SIS at Pernis.

(2) Represents our 50% joint venture interest in Kraton JSR Elastomers K.K., which is accounted for using the equity method of accounting.

	As of December 31,				
	2011	2010	2009	2008	2007
	(in thousands)				
Consolidated balance sheets data:					
Cash and cash equivalents	$ 88,579	$ 92,750	$ 69,291	$ 101,396	$ 48,277
Total assets	$ 1,153,756	$ 1,080,723	$ 974,499	$ 1,031,874	$ 984,894

Total debt	$ 392,500	$ 382,675	$ 384,979	$ 575,316	$ 538,686

	2011	2010	2009	2008	2007
Other data:					
Ratio of earnings to fixed charges	3.54:1.00	5.07:1.00	0.95:1.00	1.93:1.00	0.20:1.00

Table of Contents

Index to Financial Statements

Our earnings were insufficient to cover our fixed charges by approximately $1.6 million and $38.1 million, for the years ended December 31, 2009 and 2007, respectively.

EBITDA and Adjusted EBITDA

We consider EBITDA and Adjusted EBITDA as important supplemental measures of our performance and believe they are frequently used by investors, securities analysts and other interested parties in the evaluation of our performance and companies in our industry. In addition, management uses these measures to evaluate operating performance; our executive compensation plan bases incentive compensation payments on our EBITDA performance, along with other factors; and our long-term debt agreements use EBITDA (with additional adjustments) to measure our compliance with certain financial covenants such as leverage and interest coverage. EBITDA and Adjusted EBITDA have limitations as an analytical tool, and you should not consider them in isolation, or as substitutes for analysis of our results under generally accepted accounting principles (GAAP) in the United States.

	Years ended December 31,		
	2011	2010	2009
		(in thousands)	
EBITDA(1)	$ 184,128	$ 185,047	$ 99,050
Adjusted EBITDA(2)	194,327	194,906	91,359

(1) EBITDA represents net income before interest, taxes, depreciation and amortization.
Some of the limitations for EBITDA as an analytical tool are:

- EBITDA does not reflect our cash expenditures, or future requirements for capital expenditures or contractual commitments;
- EBITDA does not reflect changes in, or cash requirements for, our working capital needs;
- EBITDA does not reflect the significant interest expense, or the cash requirements necessary to service interest or principal payments, on our debt;
- although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will often have to be replaced in the future, and EBITDA does not reflect any cash requirements for such replacements; and
- other companies in our industry may calculate EBITDA differently than we do, limiting its usefulness as a comparative measure.

(2) We present Adjusted EBITDA as a further supplemental measure of our performance and because we believe these additional adjustments provide helpful information to securities analysts, investors and other interested parties evaluating our performance. We prepare Adjusted EBITDA by adjusting EBITDA to eliminate the impact of a number of items we do not consider indicative of our ongoing operating performance. We explain how each adjustment is derived and why we believe it is helpful and appropriate in the reconciliation below. You are encouraged to evaluate each adjustment and the reasons we consider it appropriate for supplemental analysis. As an analytical tool, Adjusted EBITDA is subject to all the limitations applicable to EBITDA. In addition, in evaluating Adjusted EBITDA, you should be aware that in the future we may incur expenses similar to the adjustments in this presentation. Our presentation of Adjusted EBITDA should not be construed as an inference that our future results will be unaffected by unusual or non-recurring items.

Because of these and other limitations, EBITDA and Adjusted EBITDA should not be considered as a measure of discretionary cash available to us to invest in the growth of our business. We compensate for these limitations by relying primarily on our GAAP results and using EBITDA and Adjusted EBITDA only as supplemental measures. See the Consolidated Statements of Cash Flows included in our financial statements included elsewhere in this Form 10-K.

Table of Contents

Index to Financial Statements

We reconcile net income (loss) to EBITDA and Adjusted EBITDA as follows:

	Years ended December 31,		
	2011	2010	2009
	(in thousands)		
Net income (loss)	$ 90,925	$ 96,725	$ (290)
Add (deduct):			
Interest expense, net	29,884	23,969	33,956
Income tax expense (benefit)	584	15,133	(1,367)
Depreciation and amortization expenses	62,735	49,220	66,751
EBITDA	$ 184,128	$ 185,047	$ 99,050
Add (deduct):			
Management fees and expenses	0	0	2,000
Restructuring and related charges(a)	1,755	6,387	9,677
Non-cash expenses(b)	5,459	3,472	4,463
(Gain) loss on extinguishment of debt	2,985	0	(23,831)
Adjusted EBITDA	$ 194,327	$ 194,906	$ 91,359

(a) 2011 includes charges related to our debt refinancing. 2011 and 2010 restructuring and related charges consisted primarily of consulting fees, severance expenses, and other charges associated with the restructuring of our European organization as well as expenses associated with the March 2011 secondary public offering of our common stock. 2009 charges consisted primarily of costs associated with the exit of the Pernis facility. All periods also reflect charges associated with evaluating merger and acquisition transactions.

(b) For all periods, consists primarily of non-cash compensation. For 2009, also reflects the non-cash inventory impairment to lower inventory from FIFO cost to market value and losses on the sale of fixed assets.

Restructuring and related charges discussed above were recorded as follows:

	Years ended December 31,		
	2011	2010	2009
	(in thousands)		
Cost of goods sold	$ 0	$ 0	$ 6,747
Selling, general and administrative	1,755	6,387	2,930
Total restructuring and related charges	$ 1,755	$ 6,387	$ 9,677

Table of Contents

Index to Financial Statements

Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

INTRODUCTION

Management s Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the Item 8. Financial Statements and Supplementary Data. This discussion contains forward-looking statements and involves numerous risks and uncertainties, including, but not limited to those described in the Item 1A. Risk Factors and below under the caption Factors Affecting Our Results of Operations. Actual results may differ materially from those contained in any forward-looking statements.

OVERVIEW

Kraton Performance Polymers, Inc. is a leading global producer of styrenic block copolymers (SBCs) and other engineered polymers. We market our products under the Kraton® brand. SBCs are highly-engineered synthetic elastomers, which we invented and commercialized almost 50 years ago, that enhance the performance of numerous end use products, imparting greater flexibility, resilience, strength, durability and processability. Our polymers are typically formulated or compounded with other products to achieve improved, customer specific performance characteristics in a variety of applications. Our SBC products are found in many everyday applications, including disposable diapers, the rubberized grips of toothbrushes, razor blades and power tools and asphalt formulations used to pave roads. We also produce Cariflex™ isoprene rubber (IR) and isoprene rubber latex (IRL). Our Cariflex™ products are highly-engineered, non-SBC synthetic substitutes for natural rubber latex. Our IRL products, which have not been found to contain the proteins present in natural rubber latex and are, therefore, not known to cause allergies, are used in applications such as surgical gloves and condoms.

We offer our customers a broad portfolio of products that includes 250 core commercial grades of SBCs. We manufacture our products along the following primary product lines based upon polymer chemistry and process technologies:

- unhydrogenated SBCs (USBCs);
- hydrogenated SBCs (HSBCs);
- isoprene rubber (IR) and IRL; and
- compounds.

We offer 119, 89, 11 and 31 core commercial grades of USBC, HSBC, IR and IRL and compounds, respectively. The majority of worldwide SBC capacity is dedicated to the production of USBCs, which are primarily used in paving and roofing, in adhesives, sealants and coatings and in footwear applications. HSBCs, which are significantly more complex and capital-intensive to manufacture than USBCs, are used in more differentiated applications, such as soft touch and flexible materials, personal hygiene products, medical products, automotive components and certain adhesives and sealant applications.

Product Line Sales Revenue(1):	2011	2010	2009
USBCs	59.5%	59.1%	56.6%
HSBCs	31.7%	31.2%	31.6%
Cariflex™	6.9%	7.5%	9.1%
Compounds	1.9%	2.2%	2.7%

(1) The percentage of sales revenue in our product line discussion excludes $4.6 million of other sales in 2011 and $47.6 million of by-product sales reported as other in 2009.

39

Table of Contents

Index to Financial Statements

In 2011, we realigned our core end use markets. The Emerging Businesses end use, which previously was comprised primarily of IR and IRL sales, has been renamed Cariflex ™, and IR sales previously reported in our Advanced Materials and in our Adhesives, Sealants and Coatings end use markets are now reported in the Cariflex™ end use. Additionally, sales of lubricant additives, which were previously not included in our four core end uses, are now reported in our Adhesives, Sealants and Coatings end use. Percentages of sales revenue and other data for our core end use markets are reported below on this realigned basis for 2011, as well as for prior periods.

	Sales Revenue Mix (1)		
End Use Markets	**2011**	**2010**	**2009**
Advanced Materials	28.0%	29.8%	28.8%
Adhesives, Sealants and Coatings	34.8%	34.3%	34.9%
Paving and Roofing	29.9%	27.8%	26.4%
Cariflex™	6.9%	7.5%	9.1%

(1) Based on 2011, 2010 and 2009 sales revenue of $1,437.5 million, $1,228.4 million and $920.4 million. Excluded from the table is $47.6 million of sales of by-products associated with production at Pernis, which we exited in 2009.

2011 Financial Highlights

Sales revenue increased 17.0% in 2011 compared to 2010.

Gross profit increased $15.7 million to $316.2 million in 2011 compared to $300.5 million in 2010.

Net income declined $5.8 million to $90.9 million or $2.81 per diluted share for 2011, compared to net income of $96.7 million, or $3.07 per diluted share for 2010.

Adjusted EBITDA decreased $0.6 million to $194.3 million in 2011 compared to $194.9 million in 2010.

Cash provided by operating activities increased $9.4 million to $64.8 million in 2011 compared to $55.4 million in 2010.

Results of Operations

Factors Affecting Our Results of Operations

Sales Revenues. We implemented a series of global price increases in 2011, which were generally broad-based across our end use markets in response to higher raw material costs and other factors.

Cost of Raw Materials. Our results of operations are directly affected by the cost of raw materials. We use butadiene, styrene, and isoprene as our primary raw materials in manufacturing our products. These monomers together represented approximately 58.8%, 55.6%, and 42.6% of our total cost of goods sold for the years ended December 31, 2011, 2010, and 2009, respectively. The cost of these monomers has generally correlated with changes in crude oil prices and prices have fluctuated significantly during the period covered by this report due to volatility in the global supply and demand of crude oil and global economic conditions. Not withstanding any volatility within a given year, our overall cost for these monomers was higher in the year ended December 31, 2011 relative to the year ended December 31, 2010 and higher in 2010 than 2009.

Butadiene, styrene and isoprene pricing has increased from 2009 through 2011 principally due to worldwide supply and demand of butadiene and natural rubber and prevailing energy prices; worldwide supply and demand of styrene, the cost of ethylene and benzene, and prevailing energy prices; the supply and demand of isoprene, the supply and prices of natural and synthetic rubber and prevailing energy prices.

Table of Contents

Index to Financial Statements

We use the first-in, first out (FIFO) basis of accounting for inventory and cost of goods sold, and therefore gross profit. In periods of raw material price volatility, reported results under FIFO will differ from what the results would have been if cost of goods sold were based on estimated current replacement cost (ECRC). Specifically, in periods of rising raw material costs, reported gross profit will be higher under FIFO than under estimated current replacement costs. Conversely, in periods of declining raw material costs, reported gross profit will be lower under FIFO than under ECRC. In recognition of the fact that the cost of raw materials affects our results of operations and the comparability of our results of operations we provide the spread between FIFO and ECRC.

In 2011, reported results under FIFO were higher than results would have been on an ECRC basis by $66.3 million;

In 2010, reported results under FIFO were higher than results would have been on an ECRC basis by $12.1 million;

In 2009, reported results under FIFO were lower than results would have been on an ECRC basis by $17.6 million.

International Operations and Currency Fluctuations. We operate a geographically diverse business, serving customers in over 60 countries from five manufacturing facilities on four continents. We generated approximately 41.0%, 40.0% and 19.0% of our 2011 sales from customers located in the Americas, Europe and Asia Pacific region, respectively. For both years ended December 31, 2010 and 2009, we generated approximately 42.0%, 37.0%, and 21.0% of our total operating revenues from customers located in the Americas, Europe and Asia Pacific regions, respectively. Although we sell and manufacture our products in many countries, our sales and production costs are mainly denominated in U.S. dollars, Euros, Japanese Yen and Brazilian Real. From time to time, we use hedging strategies to reduce our exposure to currency fluctuations.

Our financial results are subject to gains and losses on currency translations, which occur when the financial statements of foreign operations are translated into U.S. dollars. The financial statements of operations outside the United States where the local currency is considered to be the functional currency are translated into U.S. dollars using the exchange rate at each balance sheet date for assets and liabilities and the average exchange rate for each period for revenues, expenses, gains and losses, and cash flows. The effect of translating the balance sheet into U.S. dollars is included as a component of accumulated other comprehensive income (loss). Any appreciation of the functional currencies against the U.S. dollar will increase the U.S. dollar equivalent of amounts of revenues, expenses, gains and losses, and cash flows, and any depreciation of the functional currencies will decrease the U.S. dollar amounts reported. Our results of operations are also subject to currency transaction risk. We incur currency transaction risk when we enter into either a purchase or sale transaction using a currency other than the local currency of the transacting entity

The estimated impact from currency fluctuations amounted to pre-tax income of $1.1 million for the year ended December 31, 2011 and pre-tax losses of $5.5 million and $3.3 million for the years ended December 31, 2010 and 2009, respectively.

Seasonality. Seasonal changes and weather conditions, although difficult to predict, typically affect the Paving and Roofing end use market resulting in higher sales volumes into this end use market in the second and third quarters of the calendar year versus the first and fourth quarters of the calendar year. Our other end use markets tend to show relatively little seasonality.

Table of Contents

Index to Financial Statements

Outlook

Prices for our primary raw materials were volatile in 2011 as evidenced by the increase in the North American contract price for butadiene from $0.86 per pound in December 2010 to a high of $1.77 per pound in August 2011. Butadiene prices declined in the fourth quarter of 2011, with the North American contract price ending the year at $0.98 per pound. Due to capacity outages in the first quarter 2012 and other supply/demand fundamentals, the price of butadiene has increased in early 2012, with the February North American contract price for butadiene at $1.19 per pound. We currently expect that the cost of our raw materials will continue to increase into the second quarter 2012.

Although the global economy has yet to recover, and despite recent increases in raw material prices, we are encouraged by customer order patterns experienced in the first two months of the first quarter. As a result, we remain optimistic about the outlook for the full year as we continue to work with our customers to penetrate new market applications with Kraton.

Summary Operating Results

Below are our operating results derived from our Consolidated Statements of Operations.

	Years ended December 31,		
	2011	2010	2009
	(in thousands, except per share data)		
Operating revenues:			
Sales	$ 1,437,479	$ 1,228,425	$ 920,362
Other(1)	0	0	47,642
Total operating revenues	1,437,479	1,228,425	968,004
Cost of goods sold	1,121,293	927,932	792,472
Gross profit	316,186	300,493	175,532
Operating expenses:			
Research and development	27,996	23,628	21,212
Selling, general and administrative	101,606	92,305	79,504
Depreciation and amortization	62,735	49,220	66,751
Total operating expenses	192,337	165,153	167,467
Gain (loss) on extinguishment of debt	(2,985)	0	23,831
Earnings of unconsolidated joint venture(2)	529	487	403
Interest expense, net	29,884	23,969	33,956
Income (loss) before income taxes	91,509	111,858	(1,657)
Income tax expense (benefit)	584	15,133	(1,367)
Net income (loss)	$ 90,925	$ 96,725	$ (290)
Earnings (loss) per common share:			
Basic	$ 2.85	$ 3.13	$ (0.01)
Diluted	$ 2.81	$ 3.07	$ (0.01)
Weighted average common shares outstanding:			
Basic	31,786	30,825	19,808
Diluted	32,209	31,379	19,808

(1) Other revenues include the sale of by-products generated in the production of IR and SIS at Pernis, which we exited in 2009.
(2) Represents our 50% joint venture interest in Kraton JSR Elastomers K.K., which is accounted for using the equity method of accounting.

Table of Contents

Index to Financial Statements

The following table summarizes certain information relating to our operating results as a percentage of total operating revenues and is derived from the financial information presented above. We believe this presentation is useful to investors in comparing historical results. Certain amounts in the table may not sum due to the rounding of individual components.

	Years ended December 31,		
	2011	2010	2009
Operating revenues:			
Sales	100.0%	100.0%	95.1%
Other	0.0	0.0	4.9
Cost of goods sold	78.0	75.5	81.9
Gross profit	22.0	24.5	18.1
Operating expenses:			
Research and development	1.9	1.9	2.2
Selling, general and administrative	7.1	7.5	8.2
Depreciation and amortization	4.4	4.0	6.9
Total operating expenses	13.4	13.4	17.3
Gain (loss) on extinguishment of debt	(0.2)	0.0	2.5
Interest expense, net	2.1	2.0	3.5
Income (loss) before income taxes	6.4	9.1	(0.2)
Income tax expense (benefit)	0.0	1.2	(0.1)
Net income (loss)	6.3%	7.9%	0.0%

Year Ended December 31, 2011 Compared to Year Ended December 31, 2010

Sales Revenues

Total sales revenue increased $209.1 million or 17.0% to $1,437.5 million from $1,228.4 million for the years ended December 31, 2011 and 2010, respectively. The increase was largely due to global product sales price increases of $177.8 million, which were primarily in response to higher raw material costs and changes in foreign currency exchange rates of $42.0 million, partially offset by decreased sales volumes of $15.3 million. Sales volumes were 303.0 kilotons and 307.1 kilotons for the years ended December 31, 2011 and 2010, respectively.

The following factors influenced our sales revenue in each of our core end use markets:

Advanced Materials. Sales revenue increased $36.4 million or 9.9% to $402.6 million from $366.2 million for the years ended December 31, 2011 and 2010, respectively. Sales revenue increased primarily due to global price increases implemented in response to rising raw material costs, on lower volumes. We saw continued growth of innovation-led volumes, driven by growth in European and Asia Pacific PVC replacement in medical and certain personal care applications. The innovation-led volume increases were offset by volume declines in less differentiated applications.

Adhesives, Sealants and Coatings. Sales revenue increased $78.6 million or 18.7% to $499.7 million from $421.1 million for the years ended December 31, 2011 and 2010, respectively. Sales revenue growth was primarily due to global price increases implemented in response to rising raw material costs. The increase was also attributable to increased sales volume into lubricant and additives applications, as well as higher volumes in our more differentiated HSBC polymer grades, including innovation-led volume growth in health and beauty gel applications, and innovation-led USBC growth in polychloroprene rubber replacement applications. These increases were partially offset by volume declines in our less differentiated polymer grades within our USBC portfolio.

Paving and Roofing. Sales revenue increased $88.0 million or 25.8% to $429.3 million from $341.3 million for the years ended December 31, 2011 and 2010, respectively. The increase was primarily due

43

Table of Contents

Index to Financial Statements

to global price increases implemented in response to rising raw material costs. We experienced improved European demand for our paving products and, to a lesser extent, in North America. Global roofing demand was down primarily due to lower demand in North America, partially offset by innovation-led volume gains in Europe.

Cariflex™. Sales revenue increased $7.4 million or 8.1% to $99.3 million from $91.9 million for the years ended December 31, 2011 and 2010, respectively. The increase reflects the continued volume growth of our Cariflex™ IRL, primarily used in surgical glove and condom applications. Furthermore, we saw continued volume growth for Cariflex™ IR in medical and coating applications.

Cost of Goods Sold

Cost of goods sold increased $193.4 million or 20.8% to $1,121.3 million from $927.9 million for the years ended December 31, 2011 and 2010, respectively. The increase was driven largely by increased monomer costs, and to a lesser extent higher operating costs, aggregating $166.6 million and, a $39.3 million increase from changes in foreign currency exchange rates, partially offset by $12.5 million due to lower sales volumes.

Gross Profit

Gross profit increased $15.7 million or 5.2% to $316.2 million from $300.5 million for the years ended December 31, 2011 and 2010, respectively. For the years ended December 31, 2011 and 2010, our reported gross profit under FIFO was higher than what it would have been under ECRC by approximately $66.3 million and $12.1 million, respectively. See Factors Affecting Our Results of Operations Cost of Raw Materials above.

Operating Expenses

Research and Development. Research and development expense increased $4.4 million or 18.5% primarily due to an increase in employee related costs commensurate with additions to staffing levels among our scientists and higher maintenance and operational costs. Research and development expenses were 1.9% of sales revenues for both of the years ended December 31, 2011 and 2010.

Selling, General and Administrative. Selling, general and administrative expenses increased $9.3 million or 10.1% primarily due to an increase in employee related costs as well as approximately $3.6 million of costs incurred during the year ended December 31, 2011 associated with the proposed joint venture with FPCC. Selling, general and administrative expenses were 7.1% and 7.5% of sales revenue for the years ended December 31, 2011 and 2010, respectively.

Depreciation and Amortization. Depreciation and amortization expense increased $13.5 million or 27.5% primarily due to higher levels of capital expenditures and the accelerated depreciation of the coal-burning boilers at our Belpre, Ohio facility associated with the EPA regulations for controlling hazardous air emission from industry boilers.

Loss on Extinguishment of Debt

In connection with the refinancing of our indebtedness in the first quarter of 2011, we incurred a $3.0 million loss on the extinguishment of debt.

Interest Expense, Net

Interest expense, net increased $5.9 million or 24.6% to $29.9 million from $24.0 million for the years ended December 31, 2011 and 2010, respectively, primarily due to a $4.2 million write-off of debt issuance costs and a $1.0 million payment to exit an interest rate swap agreement related to the debt refinancing that occurred in the first quarter of 2011. The average debt balances outstanding were $397.9 million at an average effective interest rate of 7.5% (6.2% excluding the above mentioned write-off of debt issuance costs and the settlement of our interest rate swap agreement associated with the debt refinancing) and $388.3 million at an average effective interest rate of 6.2% for the years ended December 31, 2011 and 2010, respectively.

Table of Contents

Index to Financial Statements

Income Tax Expense

Our income tax expense was $0.6 million and $15.1 million for the years ended December 31, 2011 and 2010, respectively. Our effective tax rates were 0.6% and 13.5% for the years ended December 31, 2011 and 2010, respectively. Our effective tax rates were lower than the statutory tax rate of 35.0% primarily due to the mix of pre-tax income earned in foreign jurisdictions and the partial release of our valuation allowance during these periods. Excluding the release of our valuation allowance, our effective tax rates would have been 19.5% and 33.9% for the years ended December 31, 2011 and 2010, respectively.

Our pre-tax income is generated in a number of tax jurisdictions and as such are subject to a number of different effective tax rates that are significantly lower than the statutory tax rate of 35.0%. In 2011, we earned $83.6 million of pre-tax income that was taxed at an effective tax rate of 11.6%. In 2010, we earned $48.5 million of pre-tax income that was taxed at an effective tax rate of 24.1%.

As of December 31, 2011 and 2010, a valuation allowance of $54.2 million and $66.4 million, respectively, had been provided for net operating loss carryforwards and other deferred tax assets in certain jurisdictions. We record a valuation allowance when it is more likely than not that some portion or all of the deferred tax assets will not be realized. For the year ended December 31, 2011, we recorded changes in the valuation allowance on deferred tax assets as a result of our assessed ability to realize the tax benefit of our net operating loss carryforwards in the United States and France. We reduced our valuation allowance by $12.2 million in 2011 of which $17.3 million represents the benefit of utilizing net operating losses in 2011 and the assessment of the ability to utilize net operating losses in future periods partially offset by a $5.1 million increase in our valuation allowance to account for changes in other comprehensive income. We consider the reversal of deferred tax liabilities within the net operating loss carryforward period, projected future taxable income and tax planning strategies in making this assessment.

Net Income

Net income was $90.9 million or $2.81 per diluted share for the year ended December 31, 2011, a decrease of $5.8 million compared to net income of $96.7 million or $3.07 per diluted share for the year ended December 31, 2010. The impact of the release of our valuation allowance increased our diluted earnings per share by $0.54 and $0.73 for the years ended December 31, 2011 and 2010, respectively.

Year Ended December 31, 2010 Compared to Year Ended December 31, 2009

Operating Revenues

Operating revenues include revenue from the sale of our core products and, prior to the exit of our Pernis facility on December 31, 2009, the sale of small quantities of by-products resulting from the manufacturing process of IR. For the year ended December 31, 2010, total operating revenues increased $260.4 million or 26.9% compared to the same period in 2009.

Sales increased $308.1 million or 33.5% compared to 2009 sales largely due to increased sales volumes of approximately $167.0 million, primarily related to the positive worldwide economic climate, increases in global product sales prices primarily in response to higher raw material costs and increased demand for our products of approximately $159.8 million, partially offset by a decrease of approximately $18.7 million from changes in foreign currency exchange rates.

In addition to the aforementioned increase in global product sales prices, which was evidenced in each of the end-uses, the following factors also influenced our sales revenue in each of our end use markets:

Advanced Materials. Sales amounted to $366.2 million in 2010, an increase of $101.0 million or 38.1% compared to 2009 sales of $265.2 million. Sales growth was primarily driven by higher demand in automotive, consumer electronics, personal care and medical device applications. In addition, growth was also realized in our innovation products, notably wire and cable, medical device, and personal care applications.

Adhesives, Sealants and Coatings. Sales amounted to $421.1 million in 2010, an increase of $99.9 million or 31.1% compared to 2009 sales of $321.2 million. The increase was primarily driven by

45

Table of Contents

Index to Financial Statements

strong core volume growth in North America and Europe, including the positive effect from the global economic recovery which spurred increased demand in personal care and specialty tape applications. Sales of innovation products progressed, as we gained momentum in removable protective films, health and beauty gels, and white elastomeric roof coatings.

Paving and Roofing. Sales amounted to $341.3 million in 2010, an increase of $98.4 million or 40.5% compared to 2009 sales of $242.9 million. We experienced improved European and emerging market growth for our roofing products and to a lesser extent, increased demand in North America roofing. Global paving demand was essentially flat compared to 2009.

Cariflex™. Sales amounted to $91.9 million in 2010, an increase of $7.8 million or 9.3% compared to 2009 sales of $84.1 million. The increase reflected the continued volume growth of our isoprene rubber products in applications such as surgical gloves and condoms.

As a result of our exit from our Pernis facility, other revenue, which had been derived from the sale of by-products generated at the Pernis facility, decreased $47.6 million or 100.0% compared to 2009 other revenue.

Cost of Goods Sold

Cost of goods sold increased $135.5 million or 17.1% to $927.9 million from $792.4 million for the years ended December 31, 2010 and 2009, respectively. The increase was driven primarily by a $133.5 million increase in monomer and other production costs and a $92.6 million increase related to the increase in sales volume. These increases were partially offset by a $47.6 million decrease in by-product costs, a $11.8 million decrease in plant turnaround costs, and a $12.4 million decrease from changes in foreign currency exchange rates. Furthermore, we also realized an $18.8 million decrease in costs associated with the 2009 shutdown of our Pernis site, which includes ongoing operating cost reductions of $11.7 million, lower restructuring costs of $6.0 million and a $1.1 million non-cash charge to write-down our inventory of spare-parts recognized in the third quarter 2009.

Gross Profit

Gross profit increased $125.0 million or 71.2% to $300.5 million from $175.5 for the years ended December 31, 2010 and 2009, respectively. For the year ended December 31, 2010, our reported gross profit under FIFO was higher than what it would have been under ECRC by approximately $12.1 million and $17.6 million lower than what it would have been for the year ended December 31, 2009. See Factors Affecting Our Results of Operations Cost of Raw Materials above.

Operating Expenses

Research and Development. Research and development expense increased $2.4 million or 11.4% largely due to higher operating costs. Research and development expense was 1.9% of operating revenues for the year ended December 31, 2010 compared to 2.2% for the same period in 2009.

Selling, General and Administrative. Selling, general and administrative expenses increased $12.8 million or 16.1% primarily due to an increase in employment related costs of $16.5 million, which includes an increase in incentive compensation costs of $10.2 million, salaries of $5.0 million, and stock-based compensation costs of $1.3 million. Furthermore, restructuring and related costs increased by approximately $3.5 million. These increases were partially offset by $4.6 million of savings from the implementation of our global ERP system, and a $2.0 million decline in management fees. Selling, general and administrative expenses were 7.5% of operating revenues for the year ended December 31, 2010 compared to 8.2% for the same period in 2009.

Depreciation and Amortization. Depreciation and amortization expense decreased $17.5 million or 26.3% largely due to the exit from our Pernis facility in December 2009.

46

Table of Contents

Index to Financial Statements

Gain on Extinguishment of Debt

We recorded a $23.8 million non-recurring cash gain related to the bond repurchase in the first half of 2009.

Interest Expense, Net

Interest expense, net for the year ended December 31, 2010 decreased $10.0 million or 29.4% to $24.0 million compared to $34.0 million during the same period in 2009 primarily due to the decline in outstanding indebtedness. The average debt balances outstanding were $388.3 million at an average effective interest rate of 6.2% and $531.0 million at an average effective interest rate of 6.4% for the years ended December 31, 2010 and 2009, respectively.

Income Tax Expense (Benefit)

Our income tax expense for the year ended December 31, 2010 was $15.1 million compared to an income tax benefit of $1.4 million for the year ended December 31, 2009. Our effective tax rates were 13.5% and (82.5)% for the years ended December 31, 2010 and 2009, respectively. Our effective tax rate was lower than the statutory tax rate of 35.0% primarily due to the mix of pre-tax income earned in foreign jurisdictions and the partial release of our valuation allowance during 2010. Our effective tax rate was more beneficial than the statutory tax rate of 35.0% primarily due to the partial release of our valuation allowance and tax accrual adjustments during 2009. Excluding the release of our valuation allowance, our effective tax rates would have been 33.9% and (25.5)% for the years ended December 31, 2010 and 2009, respectively.

As of December 31, 2010 and 2009, a valuation allowance of $66.4 million and $86.4 million, respectively, had been provided for net operating loss carryforwards and other deferred tax assets in certain jurisdictions. We record a valuation allowance when it is more likely than not that some portion or all of the deferred tax assets will not be realized. For the year ended December 31, 2010, we recorded changes in the valuation allowance on deferred tax assets as a result of our assessed ability to realize the tax benefit of our net operating loss carryforwards in the United States and France. We reduced our valuation allowance by $20.0 million in 2010 of which $22.8 million represents the benefit of utilizing net operating losses in 2010, partially offset by a $2.8 million increase in our valuation allowance to account for changes in other comprehensive income. We consider the reversal of deferred tax liabilities within the net operating loss carryforward period, projected future taxable income and tax planning strategies in making this assessment.

Net Income (Loss)

Net income was $96.7 million or $3.07 per diluted share for the year ended December 31, 2010, an increase of $97.0 million compared to a net loss of $0.3 million or $(0.01) per diluted share in the same period in 2009. For the year ended December 31, 2009, we realized a gain on the extinguishment of debt that amounted to $1.20 per diluted share. The impact of the release of our valuation allowance increased our diluted earnings per share by $0.73 and $0.05 for the years ended December 31, 2010 and 2009, respectively.

Critical Accounting Policies

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make assumptions and estimates that directly affect the amounts reported in the consolidated financial statements. Certain critical accounting policies requiring significant judgments, estimates, and assumptions are detailed in this section. We consider an accounting estimate to be critical if (1) it requires assumptions to be made that are uncertain at the time the estimate is made, and (2) changes to the estimate or different estimates that could have reasonably been used would have materially changed our consolidated financial statements.

Table of Contents

Index to Financial Statements

We believe the current assumptions and other considerations used to estimate amounts reflected in our consolidated financial statements are appropriate. However, should our actual experience differ from these assumptions and other considerations used in estimating these amounts, the impact of these differences could have a material impact on our consolidated financial statements.

Allowance for Doubtful Accounts. The allowance for doubtful accounts is our best estimate of the amount of probable credit losses in our existing receivables and is determined based on our assessment of the credit worthiness of individual customers, historical write-off experience and global economic data. We review the allowance for doubtful accounts quarterly. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. We do not have any off-balance sheet credit exposure related to our customers.

Inventories. Our inventory is principally comprised of finished goods inventory. Inventories are stated at the lower of cost or market as determined on a first-in, first-out basis. We evaluate the carrying cost of our inventory on a quarterly basis for this purpose. If the cost of the inventories exceeds their market value, provisions are made for the difference between the cost and the market value.

Property, Plant and Equipment. Property, plant and equipment are recorded at cost. Major renewals and improvements that extend the useful lives of equipment are capitalized. Repair and maintenance costs are expensed as incurred. Disposals are removed at carrying cost less accumulated depreciation with any resulting gain or loss reflected in earnings. We capitalize interest costs which are incurred as part of the cost of constructing major facilities and equipment. Approximately $2.3 million, $0.5 million and $0.0 million of interest cost were capitalized in 2011, 2010 and 2009, respectively. Depreciation is recognized using the straight-line method over the following estimated useful lives:

Machinery and equipment	20 years
Building and land improvements	20 years
Manufacturing Control Equipment	10 years
Office equipment	5 years
Research equipment and facilities	5 years
Vehicles	5 years
Computer hardware/information systems	3 years

Long-Lived Assets. In accordance with Impairment or Disposal of Long-Lived Assets Subsections of FASB ASC Subtopic 360-10, *Property, Plant, and Equipment Overall*, (FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets)*, long-lived assets, such as property, plant, and equipment, and purchased intangible assets subject to amortization are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If circumstances require a long-lived asset or asset group be tested for possible impairment, we first compare undiscounted cash flows expected to be generated by that asset or asset group to its carrying value. If the carrying value of the long-lived asset or asset group is not recoverable on an undiscounted cash flow basis, an impairment is recognized to the extent that the carrying value exceeds its fair value. Fair value is determined through various valuation techniques including discounted cash flow models, quoted market values and third-party independent appraisals, as considered necessary.

Asset Retirement Obligations (ARO). Our ARO consists of estimated costs of dismantlement, removal, site reclamation and similar activities associated with our facilities. We recognize the fair value of a liability for an ARO in the period in which we have an existing legal obligation associated with the retirement of our facilities and the obligation can reasonably be estimated. The associated asset retirement cost is capitalized as part of the carrying cost of the asset. The recognition of an ARO requires that management make numerous estimates, assumptions and judgments regarding such factors as the existence of a legal obligation for an ARO;

Table of Contents

Index to Financial Statements

estimated probabilities, amounts and timing of settlements; the credit-adjusted risk-free rate to be used; discount rate and inflation rates. In periods subsequent to initial measurement of the ARO, we recognize changes in the liability resulting from the accretion of the liability to its non-discounted amount and revisions to either the timing or the amount of the original estimate of undiscounted cash flows. Revisions also result in increases or decreases in the carrying cost of these assets. Increases in the ARO liability due to accretion is charged to depreciation and amortization expense. The related capitalized cost, including revisions thereto, is charged to depreciation and amortization expense. Our ARO totaled $9.0 million at December 31, 2011. See Note 11 *Commitments and Contingencies* (subsection (c)) to the consolidated financial statements.

Contingencies. We are routinely involved in other litigation, claims and disputes incidental to our business, which at times involve claims for significant monetary amounts, some of which would not be covered by insurance. In the opinion of management, none of these other existing litigation matters or claims or disputes will have a material adverse effect on our financial position, results of operations or cash flows. However, a substantial settlement payment or judgment in excess of our accruals could have a material adverse effect on our financial position, results of operations or cash flows.

Share-Based Compensation. Share-based compensation cost is measured at the grant date based on the fair value of the award. We recognize these costs using the straight-line method over the requisite service period. The Kraton Performance Polymers, Inc. Equity Incentive Plan (the Equity Plan) allows for the grant to key employees, independent contractors, and eligible non-employee directors of incentive stock options, non-qualified stock options (which together with the incentive stock options, are referred to herein as (Options)), stock appreciation rights, restricted stock awards and restricted stock unit awards, in addition to other equity or equity-based awards as our board determines from time to time. We estimate the fair value of stock options using the Black-Scholes valuation model. Since our equity interests were privately held prior to the initial public offering, the estimated volatility is based on the historical volatility of similar companies stock that is publicly traded. Until such time we have enough publicly traded stock history, we will continue to estimate volatility of options granted (including options granted in 2011) based on the historical volatility of similar companies stock that is publicly traded. The expected term of options represents the period of time that options granted are expected to be outstanding. For all periods presented, we used the simplified method to calculate the expected term of options. The risk free interest rate for the periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. For all periods presented, the dividend yield is assumed to be zero based on historical and expected dividend activity. Forfeitures are based substantially on the history of cancellations of similar awards granted in prior years. See Note 3 *Share-Based Compensation* to the consolidated financial statements.

Income Taxes. We conduct operations in separate legal entities in different jurisdictions. As a result, income tax amounts are reflected in our consolidated financial statements for each of those jurisdictions.

Net operating losses and credit carryforwards are recorded in the event such benefits are expected to be realized. Deferred taxes result from differences between the financial and tax bases of our 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. In determining whether a valuation allowance is required, the company evaluates primarily (a) the impact of cumulative losses in past years, and (b) current and/or recent losses. A recent trend in earnings despite cumulative losses is a prerequisite to considering not recording a valuation allowance.

In assessing the realizability of deferred tax assets, we consider whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. We consider the scheduled reversal of deferred tax liabilities, projected future taxable income and tax planning strategies in making this assessment. Based upon the level of historical taxable income and projections for future taxable income over the periods in which the deferred tax assets are deductible, we believe

Table of Contents

Index to Financial Statements

it is more likely than not that we will realize the benefits of these deductible differences, net of the existing valuation allowances.

Benefit Plan Valuations. We sponsor a noncontributory defined benefit pension plan (Pension Plan), a non-qualified defined benefit pension plan, and an additional post-retirement benefit plan (Retiree Medical Plan). Management annually evaluates significant assumptions related to the benefits and obligations of these plans. Management s estimation of the projected benefit obligations and related benefit expense requires that certain assumptions be made regarding such variables as expected return on plan assets, discount rates, rates of future compensation increases, estimated future employee turnover rates and retirement dates, distribution election rates, mortality rates, retiree utilization rates for health care services and health care cost trend rates. The determination of the appropriate assumptions requires considerable judgment concerning future events and has a significant impact on the amount of the obligations and expense recorded. Our management relies in part on actuarial studies when determining the appropriateness of certain of the assumptions used in determining the benefit obligations and the annual expenses for these plans.

The discount rates are determined annually and are based on rates of return of high-quality long-term fixed income securities currently available with maturities consistent with the projected benefit payout period. The expected long-term rate of return on assets is derived from a review of anticipated future long-term performance of individual asset classes and consideration of an appropriate asset allocation strategy, given the anticipated requirements of the Pension Plan, to determine the average rate of earnings expected on the funds invested to provide for the pension plan benefits. Management also considers recent fund performance and historical returns in establishing the expected rate of return.

Movements in the capital markets impact the market value of the investment assets used to fund our Pension Plan. Future changes in plan asset returns, assumed discount rates and various other factors related to our pension and post-retirement plans will impact future pension expenses and liabilities.

The estimated effect of alternate assumptions on the 2012 estimated annual expense for the Pension Plan and Retiree Medical Plan were performed at varying discount rates, expected return on assets, expected salary increase, and, in the case of our Retiree Medical Plan, health care cost increases.

The measurement date of the Pension Plan s assets and obligations was December 31, 2011. Management applied a 4.83% discount rate, assumed an 8.5% long term rate of return on plan assets and assumed an expected salary rate increase of 3.0%. The percentage of equity securities in our Pension Plan as of December 31, 2011 was approximately 44.6%, up from approximately 38.0% as of December 31, 2010, and the percentage of debt securities as of December 31, 2011 was approximately 44.9%, down from approximately 52.8% as of December 31, 2010. The plan s strategic target asset allocation as of December 31, 2011 was 50% equity, 30% debt and 20% other, with the other component consisting of real estate funds, hedge funds and commodity funds. We have assumed that the funds in the other category together would behave similarly to debt and therefore included the 20% other as bonds in our assessment. Our management estimated a range of returns on the plan assets using a historical stochastic simulation model that determines the compound average annual return (assuming these asset classes stocks, bonds and cash) over a 20-year historical period (the approximate duration of our liabilities under the Pension Plan). The distribution of results from these simulations provides the best estimate range, 25% of the simulations lie above and 25% of the simulations lie below this range. Based on the plan s current target asset allocation, the reasonably anticipated range for asset returns (before non-investment expenses) was 6.5% to 10.5%. The asset return assumption set for determining the 2012 FASB ASC 715 expense was 8.5%, after non-investment expenses paid by the Trust. This is equivalent to a gross assumption of an 8.8% rate of return, less 0.3% for non-investment expenses, resulting in a return of 8.5% net of expenses. This assumed 8.8% rate falls within the best-estimate range, between the 50th and 75th percentile. For the Pension Plan, a 100 basis point decrease in the assumed discount rate would result in a corresponding increase of $2.1 million in our estimated Pension Plan expense for 2012. A 100 basis point decrease from 8.5% in the rate of return on plan assets would result in a corresponding increase of $0.7 million, and a 100 basis point

Table of Contents

Index to Financial Statements

increase in the expected salary rate would result in a corresponding increase of $1.0 million in expenses for 2012, in each case holding all other assumptions and factors constant.

For the Retiree Medical Plan, a 100 basis point decrease in the assumed discount rate would result in a corresponding increase of $0.3 million in our estimated expense and a 100 basis point increase in the assumed health care trend rate would result in a corresponding increase of $0.1 million in our estimated expense for 2012, in each case holding all other assumptions and factors constant. For additional information about our benefit plans, See Note 12 *Employee Benefits* to the consolidated financial statements.

Revenue Recognition. Sales are recognized in accordance with the provisions of ASC 605, *Revenue Recognition Overall*, when the revenue is realized or realizable, and has been earned. Revenue for product sales is recognized when risk and title to the product transfer to the customer, which usually occurs at the time shipment is made. Our products are generally sold free on board shipping point or, with respect to countries other than the United States, an equivalent basis. As such, title to the product passes when the product is delivered to the freight carrier. Our standard terms of delivery are included in our contracts of sale, order confirmation documents and invoices. Shipping and other transportation costs charged to customers are recorded in both sales and cost of sales.

We have entered into agreements with some of our customers whereby they earn rebates from us when the volume of their purchases of our product reach certain agreed upon levels. We recognize the rebate obligation ratably, as a reduction of revenue.

LIQUIDITY AND CAPITAL RESOURCES

Known Trends and Uncertainties

Kraton Performance Polymers, Inc. is a holding company without any operations or assets other than the operations of its subsidiaries.

Based upon current and anticipated levels of operations, we believe that cash flows from operations of our subsidiaries, cash on hand, and borrowings available to us will be sufficient to fund our working capital requirements, scheduled debt payments, interest payments, capital expenditures, benefit plan contributions, and income tax obligations. However, these cash flows are subject to a number of factors, including, but not limited to, earnings, sensitivities to the cost of raw materials, seasonality and fluctuations in foreign currency exchange rates. Because feedstock costs generally represent approximately 50% of our cost of goods sold (58.8% in 2011), in periods of rising feedstock costs, we consume cash in operating activities due to increases in accounts receivable and inventory costs, partially offset by increased value of accounts payable. Conversely, during periods in which feedstock costs are declining, we generate cash flow from decreases in working capital.

Going forward there can be no assurance that our business will generate sufficient cash flow from operations or that future borrowings will be available under the senior secured credit facility to fund liquidity needs and enable us to service our indebtedness. At December 31, 2011, we had $88.6 million of cash and cash equivalents. Our available cash and cash equivalents are held in accounts managed by third-party financial institutions and consist of cash invested in interest bearing funds and operating accounts. To date, we have not experienced any losses or lack of access to our invested cash or cash equivalents; however, we cannot provide any assurances that adverse conditions in the financial markets will not impact access to our invested cash and cash equivalents.

We have in place a $350 million senior secured credit agreement that provides for financing consisting of a $200 million senior secured revolving credit facility, a $150 million senior secured term loan facility and an option to raise up to $125 million of incremental term loans or incremental revolving credit commitments. We have borrowed substantially all of the available commitments under the term loan portion of our credit facility.

Table of Contents

Index to Financial Statements

Under the terms of our senior secured credit facility, we are subject to certain financial covenants, including maintenance of a maximum consolidated net leverage ratio, a minimum consolidated net interest coverage ratio and maximum capital expenditures. Our failure to comply with any of these financial covenants would give rise to a default under the senior secured credit facility. The maintenance of these financial ratios is based on our level of profitability. If factors arise that negatively impact our profitability, we may not be able to satisfy our covenants. If we are unable to satisfy such covenants or other provisions at any future time we would need to seek an amendment or waiver of such financial covenants or other provisions. The respective lenders under our senior secured credit facility may not consent to any amendment or waiver requests that we may make in the future, and, if they do consent, they may not do so on terms that are favorable to us. In the event that we were unable to obtain any such waiver or amendment and we were not able to refinance or repay our senior secured credit facility, our inability to meet the financial covenants or other provisions of our senior secured credit facility would constitute an event of default under our senior secured credit facility, which would permit the bank lenders to accelerate the senior secured credit facility. Such acceleration may in turn constitute an event of default under our senior notes or other debt instruments.

As of the date of the filing of this report, we have no outstanding draws under the revolving portion of our senior secured credit facility and therefore have available to us, upon covenant compliance under the credit agreement, $200.0 million under such revolving portion. While we expect to meet the conditions required to provide us full access to the revolving portion of the senior secured credit facility, we cannot guarantee that all of the counterparties contractually committed to fund a revolving credit draw request will actually fund future requests, although we currently believe that each of the counterparties would meet their funding requirements. The term loan and revolving portions of the facility mature in February 2016. For additional information regarding our credit agreement, see Senior Secured Credit Agreement in Note 7 *Long-Term Debt* to the consolidated financial statements, which is incorporated herein by reference.

We currently expect 2012 capital expenditures will be approximately $70.0 million to $80.0 million. Included in this estimate is approximately $20.0 million related to the semi-works plant and health, safety and environmental infrastructure and maintenance projects which typically range from $16.0 million to $22.0 million. The remaining 2012 capital expenditures are primarily associated with projects to optimize the production capabilities of our manufacturing assets. In addition, we currently estimate our share of the funding for the joint venture with FPCC to be approximately $70.0 million in 2012. This estimate is dependent on a number of factors, including final project cost, timing, and the extent to which the project can be funded through third party debt financing, which will impact the equity contributions to be made by us and FPCC. We currently anticipate funding our 2012 contributions with available liquidity and/or through alternative incremental funding sources.

We made contributions of $7.4 million to our pension plan in fiscal year 2011 and expect total contributions to be $9.8 million in 2012. If the market value of these assets does not improve during 2012, higher levels of contributions could be required in 2013 and beyond.

As of December 31, 2011, we had $82.5 million of cash and short-term investments related to foreign operations that management asserts are permanently reinvested. As a result of certain net operating loss carryforwards, management estimates approximately $1.7 million of additional tax expense would be incurred if this cash were repatriated.

Turbulence in U.S. and international markets and economies may adversely affect our liquidity and financial condition, and the liquidity and financial condition of our customers, and our ability to timely replace maturing liabilities and access the capital markets to meet liquidity needs, resulting in adverse effects on our financial condition and results of operations. However, to date we have been able to access borrowings available to us in amounts sufficient to fund liquidity needs.

Our ability to pay principal and interest on our indebtedness, fund working capital, make anticipated capital expenditures and fund our investment in the joint venture with FPCC depends on our future performance, which is subject to general economic conditions and other factors, some of which are beyond our control. See *Part I, Item 1A. Risk Factors* for further discussion.

Table of Contents

Index to Financial Statements

Operating Cash Flows

Net cash provided by operating activities totaled $64.8 million and $55.4 million for the years ended December 31, 2011 and 2010, respectively. This represents a net increase of $9.4 million of which $8.1 million was driven by changes in working capital including:

- $23.5 million due to lower value added taxes receivable largely due to timing;
- $14.6 million due to improved collection of accounts receivables; and
- $7.3 million increase in trade accounts payable primarily due to increases in the cost of raw materials and the timing of payments; partially offset by
- $28.3 million higher inventories of products, materials and supplies, largely due to increases in the cost of raw materials; and
- $12.1 million due to the timing of payments associated with employee related costs, maintenance and payments to our joint venture in Japan.

Cash and cash equivalents decreased to $88.6 million at December 31, 2011 from $92.8 million at December 31, 2010. Amounts undrawn on the revolving portion of our credit facility amounted to $200.0 million and $80.0 million at December 31, 2011 and 2010, respectively. Therefore, liquidity amounted to $288.6 million and $172.8 million at December 31, 2011 and 2010, respectively.

Net cash provided by operating activities totaled $55.4 million for the year ended December 31, 2010 compared to $72.8 million for the year ended December 31, 2009. This represents a decline of $17.4 million or 24.0% largely due to higher levels of working capital, partially offset by higher net earnings. Net income for the year ended December 31, 2010 was $97.0 million higher than the year ended December 31, 2009. After adjusting net income for certain items, including, but not limited to, depreciation and amortization, the gain on extinguishment of debt and deferred taxes that are necessary to reconcile net income to cash provided by operating activities, we generated $113.6 million more cash in 2010 than in 2009. However, this increase was more than offset by higher levels of working capital which consumed $101.8 million of cash in the year ended December 31, 2010 compared to providing $29.2 million of cash in 2009. This $131.0 million decrease in cash flows period over period was primarily driven by:

- a $90.8 million increase in inventories of products, materials and supplies, largely due to increases in the cost of raw materials and inventory quantity;
- a $24.6 million increase in other assets; and
- a $14.4 million decrease in other payables and accruals.

Cash and cash equivalents increased to $92.8 million at December 31, 2010 from $69.3 million at December 31, 2009. Amounts undrawn on the revolving portion of our credit facility, amounted to $80.0 million at December 31, 2010 and 2009, respectively. Therefore, liquidity, amounted to $172.8 million and $149.3 million and at December 31, 2010 and 2009, respectively.

Investing Cash Flows

Net cash used in investing activities totaled $64.4 million and $55.7 million for the years ended December 31, 2011 and 2010, respectively. Capital projects in 2011 included the following:

$14.0 million to replace IR production from the closure of our Pernis facility;

$7.2 million related to the Asia HSBC facility;

$4.1 million for IRL expansion at our Paulinia facility; and

$3.2 million for the multi-year systems and control upgrades at our Belpre facility.

Table of Contents

Index to Financial Statements

The remaining 2011 capital expenditures were primarily associated with projects to optimize the production capabilities of our manufacturing assets and ongoing health, safety and environmental infrastructure and maintenance projects.

Net cash used in investing activities totaled $55.7 million in 2010 compared to net cash used in investing activities of $49.6 million during the same period in 2009. Capital projects in 2010 included the following:

- $13.9 million associated with transferring IR production from Pernis to our Belpre facility;
- $8.2 million for upgrades of certain systems and operating controls at our Belpre facility;
- $6.7 million for the IRL debottleneck and expansion project at our Paulinia facility.

The remaining 2010 capital expenditures were primarily associated with projects to optimize the production capabilities of our manufacturing assets and ongoing health, safety and environmental infrastructure and maintenance projects.

Financing Cash Flows and Liquidity

Our consolidated capital structure as of December 31, 2011 was approximately 56.9% equity and 43.1% debt compared to approximately 54.2% equity and 45.8% debt as of December 31, 2010.

Net cash used in financing activities totaled $0.1 million and cash provided by financing activities totaled $16.5 million for the years ended December 31, 2011 and 2010, respectively. The $16.6 million decrease was driven primarily by:

- $15.2 million paid for debt issuance costs related to the debt refinancing in February 2011; and
- $10.7 million in net proceeds from the exercise of the underwriters over-allotment option in January 2010 related to our initial public offering in December 2009; partially offset by
- $9.1 million increase in net proceeds from debt.

Net cash provided by financing activities totaled $16.5 million in 2010 compared to $40.6 million net cash used in financing activities during the same period in 2009. The $57.1 million increase was driven primarily by:

- $10.7 million in net proceeds from the exercise, in January 2010, of the underwriters over-allotment option related to our initial public offering;
- $8.0 million of proceeds received from employees exercising of stock options; and
- In 2009, $11.2 million of cash was used to purchase and extinguish $30.7 million face value of our senior subordinated notes; and cash repayments of $50.0 million and $100 million were made on the senior secured credit facility in June 2009 and December 2009, respectively; partially offset by

$126.7 million in proceeds from the issuance of common stock from our initial public offering in December 2009.

2011 Refinancing

On February 11, 2011, we refinanced our existing indebtedness by completing an offering of $250.0 million in aggregate principal amount of 6.75% Senior Notes due 2019 and entering into our $350.0 million senior secured credit agreement, which is described above. The notes are unsecured obligations of our subsidiaries Kraton Polymers LLC and Kraton Polymers Capital Corporation, guaranteed by us and all of our wholly owned domestic subsidiaries. Prior to March 1, 2015, we may redeem some or all of the notes for their principal amount plus a make-whole premium. After that date we can redeem some or all of the notes for 103.375% of their principal amount and decreasing premiums each year thereafter to par. Prior to March 1, 2014, we may redeem up to 35% of the notes with proceeds from certain equity offerings at 106.75% of their principal amount. The

Table of Contents

Index to Financial Statements

notes and our credit agreement contain restrictions on our and our subsidiaries ability to, among other things, place liens on our or our subsidiaries assets; make investments other than permitted investments; incur additional indebtedness; merge, consolidate or dissolve; sell assets; engage in transactions with affiliates; change the nature of our business; change our or our subsidiaries fiscal year or organizational documents; and make restricted payments (including certain equity issuances). See Note 7 *Long-Term Debt* to the consolidated financial statements accompanying this report for further discussion.

Other Contingencies

As a chemicals manufacturer, our operations in the United States and abroad are subject to a wide range of environmental laws and regulations at both the national and local levels. These laws and regulations govern, among other things, air emissions, wastewater discharges, solid and hazardous waste management, site remediation programs and chemical use and management.

Pursuant to these laws and regulations, our facilities are required to obtain and comply with a wide variety of environmental permits for different aspects of their operations. Generally, many of these environmental laws and regulations are becoming increasingly stringent, and the cost of compliance with these various requirements can be expected to increase over time.

In the context of the separation in February 2001, Shell Chemicals agreed to indemnify us for specific categories of environmental claims brought with respect to matters occurring before the separation. However, the indemnity from Shell Chemicals is subject to dollar and time limitations. Coverage under the indemnity also varies depending upon the nature of the environmental claim, the location giving rise to the claim and the manner in which the claim is triggered. Therefore, if claims arise in the future related to past operations, we cannot give assurances that those claims will be covered by the Shell Chemicals indemnity and also cannot be certain that any amounts recoverable will be sufficient to satisfy claims against us.

In addition, we may in the future be subject to claims that arise solely from events or circumstances occurring after February 2001, which would not, in any event, be covered by the Shell Chemicals indemnity. While we recognize that we may in the future be held liable with respect for remediation activities beyond those identified to date, at present we are not aware of any circumstances that are reasonably expected to give rise to remediation claims that would have a material adverse effect on our results of operations or cause us to exceed our projected level of anticipated capital expenditures.

The EPA issued new MACT standards for controlling hazardous air emissions from industrial boilers. The Boiler MACT standards are required under Sections 112 of the Clean Air Act. The Boiler MACT rule applies to the coal-burning boilers at our Belpre, Ohio, facility. The final rule was published in the Federal Register on March 21, 2011 and was to have become effective 60 days later on May 20, 2011, if it was not otherwise changed or delayed. On May 16, 2011, the EPA announced a stay and reconsideration of the Boiler MACT rule and established a new comment period, which was open until July 15, 2011, in order to allow the EPA to continue to seek additional public comment before proposing a revised Boiler MACT rule. In December 2011, the EPA proposed a reconsidered Boiler MACT rule in lieu of the March 2011 version that was subject to a 60-day comment period. Litigation against the EPA by environmental interest groups resulted in the EPA s delay notice being vacated by the Federal court in January 2012. The Boiler MACT rule will likely impact the operation of the Belpre coal-burning boilers after the compliance date. Capital expenditures necessary to comply with the Boiler MACT rule are estimated to be $40.0 million to $50.0 million, of which approximately $0.9 million was incurred in 2011, $2.2 million is expected to be incurred in 2012 and the balance is expected to be incurred between 2013 and 2015, if the above rule is finalized.

Except for the foregoing, we currently estimate that any expenses incurred in maintaining compliance with environmental laws and regulations will not materially affect our results of operations or cause us to exceed our

Table of Contents

Index to Financial Statements

level of anticipated capital expenditures. However, we cannot give assurances that regulatory requirements or permit conditions will not change, and we cannot predict the aggregate costs of additional measures that may be required to maintain compliance as a result of such changes or expenses.

We had no material operating expenditures for environmental fines, penalties, government imposed remedial or corrective actions during the years ended December 31, 2011, 2010, or 2009. Management believes that we are in material compliance with all current environmental laws and regulations.

Off-Balance Sheet Arrangements

We are not a party to any material off-balance sheet arrangements as of December 31, 2011.

Contractual Obligations

Our principal outstanding contractual obligations relate to the term loan under the senior secured credit facility and the senior notes, the operating leases of some of our facilities and the feedstock contracts with Shell Chemicals, or its affiliates, LyondellBasell and others to provide us with styrene, butadiene and isoprene. The following table summarizes our contractual cash obligations for the periods indicated. Contractual Obligations as of December 31, 2011 are as follows:

		Payments Due by Period					
Dollars in Millions	**Total**	**2012**	**2013**	**2014**	**2015**	**2016**	**2017 and after**
Long-term debt obligations	$ 392.5	$ 7.5	$ 11.2	$ 15.0	$ 108.8	$ 0	$ 250.0
Estimated interest payments on debt	147.6	23.6	23.5	24.7	20.8	18.4	36.6
Operating lease obligations(2)	50.0	11.2	6.2	5.1	4.9	4.2	18.4
Purchase obligations(1)(2)	2,058.9	153.9	114.6	88.0	89.8	82.1	1,530.5
Estimated Pension obligations(3)	34.5	8.1	5.8	5.8	5.0	4.5	5.3
Total contractual cash obligations	$ 2,683.5	$ 204.3	$ 161.3	$ 138.6	$ 229.3	$ 109.2	$ 1,840.8

(1) Pursuant to the styrene and butadiene feedstock supply contracts with Shell Chemicals and its affiliates, we are obligated to purchase minimum quantities. The contracts do not contain a stated penalty for failure to purchase the minimum quantities. However, if we do not purchase the minimum requirements, it is required under the terms of the contracts that we meet with Shell Chemicals in an effort to determine a resolution equitable to both parties.

(2) Pursuant to production agreements with LyondellBasell, we are currently paying the costs incurred by them in connection with the operation and maintenance of, and other services related to, our European facilities. These obligations are not included in this table. The terms of these agreements range between 20 years and 40 years and each agreement includes bilateral renewal rights.

(3) This represents our future pension contributions utilizing the following assumptions:

The plan was frozen at December 31, 2011;
All assets at December 31, 2011 were moved into a portfolio of high quality bonds whose cash flow matches the expected cash flow of the frozen plan and assets were assumed to remain in such portfolio until all obligations of the plan were paid out;
An estimated Pension Protection Act of 2006 effective rate as of January 1, 2012 of 5.7%;
All contributions are made at the latest date allowable by law; and
All other assumptions as used in the 2011 funding actuarial valuation of the plan are met.

Impact of Inflation. Our results of operations and financial condition are presented based on historical cost. While it is difficult to accurately measure the impact of inflation due to the imprecise nature of the estimates required, we believe the effects of inflation, if any, on our results of operations and financial condition have been immaterial.

Table of Contents

Index to Financial Statements

Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

We are exposed to certain market risks, including risks from changes in interest rates, foreign currency exchange rates, and commodity prices, which could impact our financial condition, results of operations and cash flows. We manage our exposure to these and other market risks through regular operating and financing activities as well as through the use of market risk sensitive instruments. We use such financial instruments as risk management tools and not for speculative investment purposes. The market risk sensitive instruments that we have entered into as of December 31, 2011 consist of an interest rate swap to hedge our variable rate debt, foreign currency option contracts and forward contracts to purchase raw materials.

Interest Rate Risk. We are exposed to interest rate risk as a result of our outstanding variable rate debt under our senior secured credit agreement. Periodically, we enter into interest rate swap agreements to hedge or otherwise protect against interest rate fluctuations on a portion of our variable rate debt. These interest rate swap agreements are designated as cash flow hedges on the exposure of the variability of future cash flows. In June 2011, we entered into a $75.0 million notional amount interest rate swap agreement. This agreement was effective as of July 15, 2011 and matures on June 15, 2014. The interest rate swap agreement provides for a fixed rate of 1.0%; therefore, including the current 3.0% margin on our Term Loan, our current hedged fixed rate is 4.0%. We recorded an unrealized loss of $0.8 million in accumulated other comprehensive income (loss) related to the effective portion of this interest rate swap for the year ended December 31, 2011. This financial instrument is recorded at its fair value as of December 31, 2011, which is driven by the 30-day LIBOR forward curve. We performed a hypothetical analysis to determine the impact to our financial position if the LIBOR forward rates increased or decreased by 10 basis points, from the rates as of December 31, 2011 for the life of the interest rate swap agreement. This hypothetical scenario would result in a change of $0.2 million in accumulated other comprehensive income (loss) as of December 31, 2011.

Foreign Currency Risk. We conduct operations in many countries around the world. Our results of operations are subject to both currency transaction risk and currency translation risk. We incur currency transaction risk when we enter into either a purchase or sale transaction using a currency other than the local currency of the transacting entity. We are subject to currency translation risk because our financial condition and results of operations are measured and recorded in the relevant domestic currency and then translated into U.S. dollars for inclusion in our historical consolidated financial statements. As of December 31, 2011, we did not have any material foreign exchange financial instruments.

Commodity Price Risk. We are exposed to commodity price risk due to our forward contractual purchase commitments for raw materials. Styrene, butadiene and isoprene are primarily supplied by a portfolio of suppliers under long-term supply contracts and arrangements with various expiration dates. We are subject to future purchase commitments for commodities under minimum purchase contracts for raw materials. Based on pricing as of December 31, 2011, a hypothetical 10.0% change in the market price for these raw materials would change our 2012 cost of goods sold by $49.3 million.

Item 8. Financial Statements and Supplementary Data.

The financial statements are set forth herein commencing on page F-5 of this report.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.

None.

Table of Contents

Index to Financial Statements

Item 9A. Controls and Procedures.

Evaluation of Disclosure Controls and Procedures

An evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15 under the Securities Exchange Act of 1934) was carried out under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer. As of December 31, 2011, based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the design and operation of these disclosure controls and procedures were effective.

Management s Annual Report on Internal Control Over Financial Reporting

See *Management s Annual Report on Internal Control Over Financial Reporting* under Item 8 of this Form 10-K.

Attestation Report of the Registered Public Accounting Firm

See *Report of Independent Registered Public Accounting Firm* under Item 8 of this Form 10-K.

Changes in Internal Control Over Financial Reporting

There has been no change in our internal control over financial reporting that occurred during the three months ended December 31, 2011 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Item 9B. Other Information.

None.

Table of Contents

Index to Financial Statements

PART III

Item 10. Directors, Executive Officers and Corporate Governance.
Information in response to this item is incorporated by reference from our Proxy Statement relating to our 2012 annual meeting of shareholders. The Proxy Statement will be filed with the SEC within 120 days after the end of the fiscal year covered by this Form 10-K pursuant to Regulation 14A under the Exchange Act.

Item 11. Executive Compensation.
Information in response to this item is incorporated by reference from our Proxy Statement relating to our 2012 annual meeting of shareholders. The Proxy Statement will be filed with the SEC within 120 days after the end of the fiscal year covered by this Form 10-K pursuant to Regulation 14A under the Exchange Act.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.
Information in response to this item is incorporated by reference from our Proxy Statement relating to our 2012 annual meeting of shareholders.

Item 13. Certain Relationships and Related Transactions, and Director Independence.
Information in response to this item is incorporated by reference from our Proxy Statement relating to our 2012 annual meeting of shareholders.

Item 14. Principal Accountant Fees and Services.
Information in response to this item is incorporated by reference from our Proxy Statement relating to our 2012 annual meeting of shareholders.

Table of Contents

Index to Financial Statements

PART IV

Item 15. Exhibits and Financial Statement Schedules.

(a) 1. Financial Statements

The following financial statements are included in Item 8:

Kraton Performance Polymers, Inc.

(i) The reports of KPMG LLP, Independent Registered Public Accounting Firm

(ii) Consolidated Balance Sheets as of December 31, 2011 and 2010

(iii) Consolidated Statements of Operations years ended December 31, 2011, 2010, and 2009

(iv) Consolidated Statements of Changes in Stockholders and Member s Equity and Other Comprehensive Income years ended December 31, 2011, 2010, and 2009

(v) Consolidated Statements of Cash Flows years ended December 31, 2011, 2010, and 2009

(vi) Notes to consolidated financial statements

2. Exhibits

The exhibits listed on the accompanying Exhibit Index are filed as part of this report and are on file with us.

(b) Exhibits

See Item 15(a) 2 above.

(c) Financial Statement Schedule

See Schedule II.

Table of Contents

Index to Financial Statements

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.

Date: February 29, 2012

Kraton Performance Polymers, Inc.

/S/ KEVIN M. FOGARTY

Kevin M. Fogarty

President and Chief Executive Officer

This report has been signed below by the following persons on behalf of the registrant and in the capacities indicated on February 29, 2012.

Signature	Title
/s/ KEVIN M. FOGARTY **Kevin M. Fogarty**	President, Chief Executive Officer and a Director (Principal Executive Officer)
/S/ STEPHEN E. TREMBLAY **Stephen E. Tremblay**	Vice President and Chief Financial Officer (Principal Financial Officer)
/S/ JASON P. CLARK **Jason P. Clark**	Chief Accounting Officer (Principal Accounting Officer)
/S/ RICHARD C. BROWN* **Richard C. Brown**	Director
/S/ ANNA C. CATALANO* **Anna C. Catalano**	Director
/S/ STEVEN J. DEMETRIOU* **Steven J. Demetriou**	Director
Dominique Fournier	Director
/S/ JOHN J. GALLAGHER, III*	Director

John J. Gallagher

/S/ BARRY J. GOLDSTEIN* Director

Barry J. Goldstein

/S/ FRANCIS S. KALMAN * Director

Francis S. Kalman

/S/ DAN F. SMITH* Director

Dan F. Smith

/S/ KAREN A. TWITCHELL* Director

Karen A. Twitchell

*By: /s/ STEPHEN E. TREMBLAY

Stephen E. Tremblay

As attorney-in-fact

Table of Contents

Index to Financial Statements

KRATON PERFORMANCE POLYMERS, INC.

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS