

Kraton Performance Polymers, Inc.
Form 10-Q
August 01, 2012
[Table of Contents](#)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2012

.. **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)

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Delaware
(State or other jurisdiction of
incorporation or organization)

15710 John F. Kennedy Blvd.

Suite 300

Houston, TX 77032
(Address of principal executive offices, including zip code)

20-0411521
(I.R.S. Employer

Identification No.)

281-504-4700
(Registrant's telephone number, including area code)

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 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 No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See 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:

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

Number of shares of Kraton Performance Polymers, Inc. Common Stock, \$0.01 par value, outstanding as of July 27, 2012: 32,240,291.

Table of Contents

Index to Quarterly Report

on Form 10-Q for

Quarter Ended June 30, 2012

PART I. FINANCIAL INFORMATION

Page

Item 1	<u>Condensed Consolidated Financial Statements (Unaudited)</u>	5
	<u>Condensed Consolidated Balance Sheets as of June 30, 2012 and December 31, 2011</u>	5
	<u>Condensed Consolidated Statements of Income for the three and six months ended June 30, 2012 and 2011</u>	6
	<u>Condensed Consolidated Statements of Comprehensive Income (Loss) for the three and six months ended June 30, 2012 and 2011</u>	7
	<u>Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2012 and 2011</u>	8
	<u>Notes to the Condensed Consolidated Financial Statements</u>	9
Item 2	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	30
Item 3	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	44
Item 4	<u>Controls and Procedures</u>	44

PART II. OTHER INFORMATION

Item 1	<u>Legal Proceedings</u>	45
Item 1A	<u>Risk Factors</u>	45
Item 6	<u>Exhibits</u>	46
	<u>Signatures</u>	47

Table of Contents

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

Some of the statements in this Quarterly Report on Form 10-Q under the headings "Condensed Consolidated Financial Statements" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" 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-K, 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; anticipated benefits of or performance of our products; beliefs regarding opportunities for new, high-margin applications; adequacy of cash flows to fund our working capital requirements, our investment in the joint venture with FPCC, scheduled debt payments, interest payments, capital expenditures, benefit plan contributions, and income tax obligations; our anticipated 2012 capital expenditures, including the amount of expenditures related to the semi-works plant, production optimization, and health, safety and environmental infrastructure and maintenance projects; our ability to meet conditions required to ensure full access to our senior secured credit facility; expectations regarding our counterparties' ability to perform, including with respect to trade receivables; anticipated aggregate and fiscal year 2012 cost estimates for the planned Taiwan manufacturing facility, the portion of such costs we expect to pay, the manner in which we expect to fund such costs, and when we currently expect the facility to become operational; estimates regarding the tax expense of repatriating certain cash and short-term investments related to foreign operations; expectations regarding Nexar; our ability to realize certain deferred tax assets and our beliefs with respect to tax positions; our expectations regarding our planned manufacturing facility in Asia if current negotiations fail; estimates related to the useful lives of certain assets for tax purposes; our anticipated dividend policy; expectations regarding our pension contributions for fiscal year 2012; estimates related to monomer costs, ending inventory levels and related estimated charges; and the outcome and financial impact of legal proceedings, including IRS review of our returns. Such forward-looking statements involve known and unknown risks, uncertainties, assumptions 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. Further description of these risks and uncertainties and other important factors are set forth in this report, in our latest Annual Report on Form 10-K, as subsequently amended on March 8, 2012, including but not limited to Part I, Item 1A. Risk Factors and Part II, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations therein, and in our other filings with the Securities and Exchange Commission, and include, but are not limited to, risks related to:

conditions in the global economy and capital markets;

our reliance on LyondellBasell Industries for the provision of significant operating and other services;

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;

limitations in the availability of raw materials we need to produce our products in the amounts or at the prices necessary for us to effectively and profitably operate our business;

competition in our end use markets by other producers of styrenic block copolymers and by producers of products that can be substituted for our products;

our ability to produce and commercialize technological innovations;

our ability to protect our intellectual property, on which our business is substantially dependent;

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the possibility that our products infringe upon the intellectual property rights of others;

seasonality in our business, particularly in our Paving and Roofing end use market;

our substantial indebtedness, which could adversely affect our financial condition and prevent us from fulfilling our obligations under the senior secured credit agreement and the senior notes;

Table of Contents

financial and operating constraints related to our indebtedness;

the inherently hazardous nature of chemical manufacturing;

product liability claims and other lawsuits arising from environmental damage, personal injuries, other damages associated with chemical manufacturing or our products;

political, economic and local business risks in the various countries in which we operate;

health, safety and environmental laws, including laws that govern our employees' exposure to chemicals deemed harmful to humans;

regulation of our company or our customers, which could affect the demand for our products or result in increased compliance and other costs;

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;

fluctuations in currency exchange rates;

our planned joint venture in Asia and whether or not it will materialize;

our relationship with our employees;

loss of key personnel or our inability to attract and retain new qualified personnel;

the fact that we generally do not enter into long-term contracts with our customers;

a decrease in the fair value of our pension assets, which could require us to materially increase future funding of the pension plan;

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

our expectation that we will not pay dividends for the foreseeable future; and

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

There may be other factors of which we are currently unaware or that we deem immaterial that may cause our actual results to differ materially from the expectations we express in our forward-looking statements. Although we believe the assumptions underlying our forward-looking

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statements are reasonable, any of these assumptions, and, therefore, also the forward-looking statements based on these assumptions could themselves prove to be inaccurate.

Forward-looking statements are based on current plans, estimates, assumptions 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 its consolidated subsidiaries. This Form 10-Q includes financial statements and related notes that present the condensed consolidated financial position, results of operations, comprehensive income (loss), and cash flows of Kraton, and its subsidiaries. Kraton is a holding company whose only material asset is its investment in its wholly owned subsidiary, Kraton Polymers LLC. Kraton Polymers LLC and its subsidiaries own all of our consolidated operating assets.

Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Condensed Consolidated Financial Statements.****KRATON PERFORMANCE POLYMERS, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(Unaudited)****(In thousands, except par value)**

	June 30, 2012	December 31, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 227,962	\$ 88,579
Receivables, net of allowances of \$507 and \$549	183,734	142,696
Inventories of products	382,483	394,796
Inventories of materials and supplies	10,379	9,996
Deferred income taxes	2,272	2,140
Other current assets	27,563	27,328
Total current assets	834,393	665,535
Property, plant, and equipment, less accumulated depreciation of \$304,314 and \$281,442	364,621	372,973
Identifiable intangible assets, less accumulated amortization of \$63,013 and \$58,530	63,817	66,184
Investment in unconsolidated joint venture	12,990	13,350
Debt issuance costs	12,386	11,106
Other long-term assets	24,498	24,608
Total assets	\$ 1,312,705	\$ 1,153,756
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Current portion of long-term debt	\$ 9,375	\$ 7,500
Accounts payable-trade	111,898	88,026
Other payables and accruals	49,713	51,253
Due to related party	30,770	14,311
Total current liabilities	201,756	161,090
Long-term debt, net of current portion	480,589	385,000
Deferred income taxes	4,763	6,214
Other long-term liabilities	86,422	83,658
Total liabilities	773,530	635,962
Commitments and contingencies (note 11)		
Stockholders equity:		
Preferred stock, \$0.01 par value; 100,000 shares authorized; none issued	0	0
Common stock, \$0.01 par value; 500,000 shares authorized; 32,240 shares issued and outstanding at June 30, 2012; 32,092 shares issued and outstanding at December 31, 2011	322	321
Additional paid in capital	351,451	347,455

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Retained earnings	216,396	187,636
Accumulated other comprehensive loss	(28,994)	(17,618)
Total stockholders' equity	539,175	517,794
Total liabilities and stockholders' equity	\$ 1,312,705	\$ 1,153,756

See Notes to Condensed Consolidated Financial Statements

Table of Contents**KRATON PERFORMANCE POLYMERS, INC.****CONDENSED CONSOLIDATED STATEMENTS OF INCOME****(Unaudited)****(In thousands, except per share data)**

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Sales revenue	\$ 375,756	\$ 386,428	\$ 784,069	\$ 731,256
Cost of goods sold	302,276	278,033	635,070	536,010
Gross profit	73,480	108,395	148,999	195,246
Operating expenses:				
Research and development	7,996	6,966	15,556	13,568
Selling, general, and administrative	26,313	27,912	52,776	55,083
Depreciation and amortization	15,885	15,604	31,734	30,230
Total operating expenses	50,194	50,482	100,066	98,881
Loss on extinguishment of debt	0	0	0	2,985
Earnings (loss) of unconsolidated joint venture	163	(880)	300	(739)
Interest expense, net	7,773	5,915	14,472	17,096
Income before income taxes	15,676	51,118	34,761	75,545
Income tax expense	3,269	4,141	6,001	6,691
Net income	\$ 12,407	\$ 46,977	\$ 28,760	\$ 68,854
Earnings per common share:				
Basic	\$ 0.38	\$ 1.47	\$ 0.89	\$ 2.16
Diluted	\$ 0.38	\$ 1.44	\$ 0.89	\$ 2.12
Weighted average common shares outstanding:				
Basic	31,930	31,757	31,919	31,683
Diluted	32,172	32,339	32,209	32,271

See Notes to Condensed Consolidated Financial Statements.

Table of Contents**KRATON PERFORMANCE POLYMERS, INC.****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)****(Unaudited)****(In thousands)**

	Three months ended		Six months ended	
	June 30,		June 30,	
	2012	2011	2012	2011
Net income	\$ 12,407	\$ 46,977	\$ 28,760	\$ 68,854
Other comprehensive income (loss):				
Foreign currency translation adjustments, net of tax of \$0	(23,371)	6,615	(13,045)	23,920
Reclassification of loss on interest rate swap, net of tax of \$0	0	0	0	1,073
Decrease (increase) in unrealized loss of interest rate swaps, net of tax of \$0	(17)	97	(134)	97
Increase in unrealized gain of net investment hedge, net of tax of \$0	1,803	0	1,803	0
Other comprehensive income (loss), net of tax	(21,585)	6,712	(11,376)	25,090
Total comprehensive income (loss)	\$ (9,178)	\$ 53,689	\$ 17,384	\$ 93,944

See Notes to Condensed Consolidated Financial Statements

Table of Contents**KRATON PERFORMANCE POLYMERS, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)****(In thousands)**

	Six months ended June 30,	
	2012	2011
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 28,760	\$ 68,854
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	31,734	30,230
Amortization of debt issuance costs	1,451	5,413
Loss on property, plant, and equipment	415	5
Loss on extinguishment of debt	0	2,985
Earnings from unconsolidated joint venture, net of dividends received	100	1,255
Deferred income tax expense (benefit)	(502)	3,335
Share-based compensation	3,737	2,949
<i>Decrease (increase) in:</i>		
Accounts receivable	(44,466)	(37,028)
Inventories of products, materials and supplies	7,154	(65,425)
Other assets	(848)	3,605
<i>Increase (decrease) in:</i>		
Accounts payable-trade	24,763	6,242
Other payables and accruals	(1,004)	(5,797)
Other long-term liabilities	622	(474)
Due to related party	16,822	(1,906)
Net cash provided by operating activities	68,738	14,243
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property, plant, and equipment, net of proceeds from sales	(22,548)	(35,060)
Purchase of software	(2,109)	(1,121)
Settlement of net investment hedge	2,854	0
Net cash used in investing activities	(21,803)	(36,181)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from debt	101,250	400,000
Repayments of debt	(3,750)	(389,410)
Proceeds from the exercise of stock options	260	7,865
Proceeds from insurance note payable	0	4,734
Repayments of insurance note payable	0	(4,734)
Debt issuance costs	(2,728)	(15,231)
Net cash provided by financing activities	95,032	3,224
Effect of exchange rate differences on cash	(2,584)	(6,791)
Net increase (decrease) in cash and cash equivalents	139,383	(25,505)

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Cash and cash equivalents, beginning of period	88,579	92,750
Cash and cash equivalents, end of period	\$ 227,962	\$ 67,245
Supplemental disclosures:		
Cash paid during the period for income taxes, net of refunds received	\$ 10,913	\$ 5,744
Cash paid during the period for interest, net of capitalized interest	\$ 11,050	\$ 10,980

See Notes to Condensed Consolidated Financial Statements

Table of Contents

KRATON PERFORMANCE POLYMERS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. General

Description of our Business. 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 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, 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, polymers used in slush molding for automotive applications, and our Nexar™ family of membrane polymers for water filtration and breathable fabrics. 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.

Basis of Presentation. The accompanying unaudited condensed consolidated financial statements we present in this report are for Kraton Performance Polymers, Inc. and its consolidated subsidiaries, each of which is a wholly-owned subsidiary. These interim financial statements should be read in conjunction with the consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2011, as subsequently amended on March 8, 2012, and reflect all normal recurring adjustments that are, in the opinion of management, necessary to fairly present our results of operations and financial position. Amounts reported in our Condensed Consolidated Statements of Income are not necessarily indicative of amounts expected for the respective annual periods or any other interim period, in particular due to the effect of seasonal changes and weather conditions that typically affect our sales into our Paving and Roofing end use market.

Our significant accounting policies have been disclosed in Note 1 *Description of Business, Basis of Presentation and Significant Accounting Policies* in our most recent Annual Report on Form 10-K, as amended. There have been no changes to the policies disclosed therein. The accompanying unaudited condensed consolidated financial statements we present in this report have been prepared in accordance with those policies.

Use of Estimates. The preparation of condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant items subject to such estimates and assumptions include the useful lives of fixed assets; allowances for doubtful accounts and sales returns; the valuation of derivatives, deferred tax assets, property, plant, and equipment, inventory, investments and share-based compensation; and liabilities for employee benefit obligations, asset retirement obligations (ARO), income tax uncertainties, and other contingencies.

Income Tax in Interim Periods. Our business operations are global in nature and we are subject to taxes in numerous jurisdictions. Tax laws and tax rates vary substantially in these jurisdictions and are subject to change

Table of Contents

given the political and economic climate in those countries. We file our tax returns in accordance with our interpretations of each jurisdiction's tax laws. We record our tax provision or benefit on an interim basis using the estimated annual effective tax rate. This rate is applied to the current period ordinary income or loss to determine the income tax provision or benefit allocated to the interim period.

Losses from jurisdictions for which no benefit can be realized and the income tax effects of unusual and infrequent items are excluded from the estimated annual effective tax rate. Valuation allowances are provided against the future tax benefits that arise from the losses in jurisdictions for which no benefit can be realized. The effects of unusual and infrequent items are recognized in the impacted interim period as discrete items.

The estimated annual effective tax rate may be significantly affected by nondeductible expenses and by our projected earnings mix by tax jurisdiction. Adjustments to the estimated annual effective income tax rate are recognized in the period during which such estimates are revised.

We have established valuation allowances against a variety of deferred tax assets, including net operating loss carryforwards, foreign tax credits and other income tax credits. Valuation allowances take into consideration our ability to realize these deferred tax assets and reduce the value of such assets to the amount that is deemed more likely than not to be recoverable. Our ability to realize these deferred tax assets is dependent on achieving our forecast of future taxable operating income over an extended period of time. We review our forecast in relation to actual results and expected trends on a quarterly basis. Failure to achieve our operating income targets may change our assessment regarding the recoverability of our net deferred tax assets and such change could result in a valuation allowance being recorded against some or all of our net deferred tax assets. A change in our valuation allowance would impact our income tax expense/benefit and our stockholders' equity and could have a significant impact on our results of operations or financial condition in future periods.

2. New Accounting Pronouncements

Adoption of Accounting Standards

We have implemented all new accounting pronouncements that are in effect and that management believes would materially impact our financial statements. Management does not believe that there are any other new accounting pronouncements that have been issued that might have a material impact on our financial position or results of operations.

3. Share-Based Compensation

We account for share-based awards under the provisions of ASC 718, *Compensation - Stock Compensation*, which established the accounting for share-based awards exchanged for employee services. Accordingly, share-based compensation cost is measured at the grant date based on the fair value of the award and we expense these costs using the straight-line method over the requisite service period. Share-based compensation expense was approximately \$1.9 million and \$1.7 million for the three months ended June 30, 2012 and 2011, and \$3.7 million and \$2.9 million for the six months ended June 30, 2012 and 2011, respectively. We record these costs in selling, general, and administrative expenses.

4. Restructuring and Restructuring-related Costs

There were no restructuring and restructuring-related expenses incurred in the three and six months ended June 30, 2012 and the three months ended June 30, 2011. In the six months ended June 30, 2011, restructuring and restructuring-related expenses amounted to approximately \$1.0 million and were comprised of charges related to consulting fees, severance expenses and other costs primarily associated with the restructuring of our European organization, which were recorded as selling, general, and administrative expenses.

Table of Contents**5. Detail of Certain Balance Sheet Accounts**

	June 30, 2012	December 31, 2011
	(in thousands)	
<i>Inventories of products:</i>		
Finished products	\$ 282,917	\$ 289,921
Work in progress	6,253	5,048
Raw materials	93,313	99,827
	\$ 382,483	\$ 394,796
<i>Other payables and accruals:</i>		
Employee related	\$ 11,725	\$ 11,639
Income taxes payable	6,805	12,254
Other	31,183	27,360
	\$ 49,713	\$ 51,253
<i>Other long-term liabilities:</i>		
Pension	\$ 74,597	\$ 74,304
Other	11,825	9,354
	\$ 86,422	\$ 83,658
<i>Accumulated other comprehensive loss:</i>		
Foreign currency translation adjustments	\$ 16,505	\$ 29,550
Net unrealized loss on interest rate swaps	(943)	(809)
Net unrealized gain on net investment hedge	2,702	899
Pension liability	(47,258)	(47,258)
	\$ (28,994)	\$ (17,618)

6. Earnings Per Share (EPS)

Basic EPS is computed by dividing net income by the weighted-average number of shares outstanding during the period.

Diluted EPS is computed by dividing net income by the diluted weighted-average number of shares outstanding during the period and, accordingly, reflects the potential dilution that could occur if securities or other agreements to issue common stock, such as stock options, were exercised, settled or converted into common stock and were dilutive. The diluted weighted-average number of shares used in our diluted EPS calculation is determined using the treasury stock method.

Unvested awards of share-based payments with rights to receive dividends or dividend equivalents, such as our restricted stock awards are considered to be participating securities, and therefore, the two-class method is used for purposes of calculating EPS. Under the two-class method, a portion of net income is allocated to these participating securities and is excluded from the calculation of EPS allocated to common stock. Our restricted stock awards are subject to forfeiture and restrictions on transfer until vested and have identical voting, income and distribution rights to the unrestricted common shares outstanding.

The computation of diluted earnings per share excludes the effect of the potential exercise of stock options that are anti-dilutive. The number of stock options excluded from the computation was 760,087 and 10,000 for the three months ended June 30, 2012 and 2011, and 723,431 and 266,205 for the six months ended June 30, 2012 and 2011, respectively.

Table of Contents

The effects of share-based compensation awards on our diluted weighted-average number of shares outstanding used in calculating our diluted EPS are as follows:

	Three months ended June 30, 2012			Three months ended June 30, 2011		
	Net Income (In thousands, except per share data)	Weighted Average Shares Outstanding	Earnings Per Share	Net Income (In thousands, except per share data)	Weighted Average Shares Outstanding	Earnings Per Share
<i>Basic:</i>						
As reported	\$ 12,407	32,241		\$ 46,977	31,932	
Less: amounts allocated to unvested restricted shares	(120)	(311)		(257)	(175)	
Amounts available to common stockholders	12,287	31,930	\$ 0.38	46,720	31,757	\$ 1.47
<i>Diluted:</i>						
Add: amounts allocated to unvested restricted shares	120	311		257	175	
Restricted share units non participating	0	29		0	30	
Stock options added under the treasury stock method	0	213		0	552	
Less: amounts reallocated to unvested restricted shares	(119)	(311)		(253)	(175)	
Amounts available to stockholders and assumed conversions	\$ 12,288	32,172	\$ 0.38	\$ 46,724	32,339	\$ 1.44

	Six months ended June 30, 2012			Six months ended June 30, 2011		
	Net Income (In thousands, except per share data)	Weighted Average Shares Outstanding	Earnings Per Share	Net Income (In thousands, except per share data)	Weighted Average Shares Outstanding	Earnings Per Share
<i>Basic:</i>						
As reported	\$ 28,760	32,191		\$ 68,854	31,827	
Less: amounts allocated to unvested restricted shares	(243)	(272)		(312)	(144)	
Amounts available to common stockholders	28,517	31,919	\$ 0.89	68,542	31,683	\$ 2.16
<i>Diluted:</i>						
Add: amounts allocated to unvested restricted shares	243	272		312	144	
Restricted share units non participating	0	29		0	33	
Stock options added under the treasury stock method	0	261		0	555	
Less: amounts reallocated to unvested restricted shares	(241)	(272)		(306)	(144)	
Amounts available to stockholders and assumed conversions	\$ 28,519	32,209	\$ 0.89	\$ 68,548	32,271	\$ 2.12

Table of Contents**7. Long-Term Debt**

In March 2012, we completed a public offering of \$100.0 million principal amount of our 6.75% senior notes due 2019 at an issue price of 101.25%. The notes constitute a further issuance of, and are fungible with, the \$250.0 million aggregate principal amount of 6.75% senior notes due 2019 that we issued on February 11, 2011. The additional notes form a single series of debt securities with the existing notes.

Concurrently with the \$100.0 million senior note offering, we entered into an amendment to our 2011 senior secured credit agreement to, among other things, facilitate our ability to pursue a new manufacturing facility by providing for an additional \$50.0 million in investment capacity for certain investments and a \$75.0 million increase to the capital expenditures basket under certain circumstances. Additionally, the amendment provides for certain modifications to the consolidated net leverage ratio we are required to maintain and provides that certain guarantees by us or any of our domestic subsidiaries not to exceed \$100.0 million shall not constitute indebtedness for purposes of compliance with certain financial covenants.

Our senior secured credit agreement provides for financing consisting of a \$200.0 million senior secured revolving credit facility, a \$150.0 million senior secured term loan facility and an option to raise up to \$125.0 million of incremental term loans or incremental revolving credit commitments. The senior secured credit agreement has a maturity date of February 11, 2016. In these notes to the condensed consolidated financial statements, the loans made under the revolving credit facility are referred to as revolving loans and the loans made under the term loan facility are referred to as term loans.

Long-term debt consists of the following:

	June 30, 2012	December 31, 2011
	(in thousands)	
Term loans	\$ 138,750	\$ 142,500
6.75% senior notes due 2019	351,214	250,000
Total debt	489,964	392,500
Less current portion of long-term debt	9,375	7,500
Total long-term debt	\$ 480,589	\$ 385,000

Senior Secured Credit Agreement. Kraton Polymers LLC is the borrower under our senior secured credit agreement, which is unconditionally guaranteed by Kraton Performance Polymers, Inc. and the wholly-owned domestic subsidiaries of Kraton Polymers LLC, and is required to be guaranteed by all future direct and indirect material domestic subsidiaries. Revolving loans bear interest at a rate per annum equal to, at our option, either (a) a base rate determined by reference to the higher of (1) the federal funds rate plus 0.50% and (2) the prime rate of Bank of America, N.A., in each case plus a margin of 1.75% to 2.25% depending on a consolidated net leverage ratio, or (b) a LIBOR rate determined by reference to the costs of funds for U.S. dollar deposits for the interest period relevant to such borrowing adjusted for certain additional costs plus a margin of 2.75% to 3.25% depending on a consolidated net leverage ratio.

Our term loans bear interest at a rate per annum equal to, at our option, either (a) a base rate determined by reference to the higher of (1) the federal funds rate plus 0.50% and (2) the prime rate of Bank of America, N.A., in each case plus a margin of 2.00% per annum, or (b) a LIBOR rate determined by reference to the costs of funds for U.S. dollar deposits for the interest period relevant to such borrowing adjusted for certain additional costs plus a margin of 3.00% per annum. The average effective interest rates, including debt issuance costs, on the term loans for the three months ended June 30, 2012 and 2011 were 3.7% and 3.3%, respectively. The average effective interest rates, including debt issuance costs, on the term loans for the six months ended June 30, 2012 and 2011 were 3.7% and 7.9% (3.7% excluding a \$2.4 million write-off of debt issuance costs related to the term loan 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), respectively.

Table of Contents

In addition to paying interest on outstanding principal under revolving loans and term loans, we are required to pay a commitment fee ranging from 0.50% to 0.75%, depending on our consolidated net leverage ratio, related to the unutilized commitments under revolving loans, as well as pay customary letter of credit fees and agency fees.

6.75% Senior Notes due 2019. Kraton Polymers LLC and its wholly-owned financing subsidiary Kraton Polymers Capital Corporation issued \$350.0 million aggregate principal amount of 6.75% senior notes that mature on March 1, 2019 pursuant to an indenture, dated as of February 11, 2011 (\$250.0 million senior notes) and supplemental indenture thereto dated as of March 20, 2012 (\$100.0 million senior notes). The indenture provides that the notes are general unsecured, senior obligations and will be unconditionally guaranteed on a senior unsecured basis. We will pay interest on the notes at 6.75% per annum, semi-annually in arrears on March 1 and September 1.

Debt Maturities. The remaining principal payments on our outstanding total debt as of June 30, 2012, are as follows:

	Principal Payments (in thousands)
December 31:	
2012	\$ 3,750
2013	11,250
2014	15,000
2015	108,750
Thereafter(1)	350,000
Total debt	\$ 488,750

(1) Excludes the \$1.2 million premium associated with the issuance of \$100.0 million principal amount of our 6.75% senior notes in March 2012.

See Note 9 *Financial Instruments and Credit Risk* for fair value information related to our long-term debt.

8. Debt Issuance Costs

We capitalize the debt issuance costs related to issuing long-term debt and amortize these costs using the effective interest method, except for costs related to revolving debt, which are amortized using the straight-line method. We had debt issuance costs of \$15.5 million and \$13.7 million (of which \$3.2 million and \$2.6 million were included in other current assets) as of June 30, 2012 and December 31, 2011, respectively. In connection with our March 2012 offering, we capitalized \$3.3 million of debt issuance costs related to the issuance of an additional \$100.0 million principal amount of our 6.75% senior notes and an amendment to our 2011 senior secured credit agreement. Debt issuance costs for the six months ended June 30, 2012 consisted of the following:

	Debt Issuance Costs (in thousands)
Debt issuance costs at December 31, 2011	\$ 13,747
Capitalization of financing fees and other costs	3,250
Amortization expense	(1,451)
Debt issuance costs at June 30, 2012	\$ 15,546

Table of Contents
9. Financial Instruments and Credit Risk***Financial Instruments***

Interest Rate Swap Agreements. 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 our exposure to the variability of future cash flows.

In June 2011, we entered into a \$75.0 million notional amount interest rate swap agreement with respect to a portion of our outstanding term loans. 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 loans, our current hedged fixed rate is 4.0%. We recorded an unrealized loss of \$0.9 million in accumulated other comprehensive loss related to the effective portion of this interest rate swap as of June 30, 2012.

In June 2010, we entered into a \$215.0 million notional amount interest rate swap agreement. This agreement was effective on January 3, 2011 and was set to expire on January 3, 2012. However, on February 10, 2011, in connection with the refinancing of our previously existing indebtedness, we terminated and settled the interest rate swap agreement, and as a result, recognized \$1.0 million of interest expense.

Fair Value Hedges. In April 2012, we entered into a series of non-deliverable forward contracts to reduce our exposure to fluctuations in the Canadian dollar (CAD) to the U.S. dollar associated with the funding of our semi-works facility at our Belpre, Ohio, facility, for the notional amounts of CAD \$1.6 million, CAD \$3.3 million, CAD \$3.3 million, CAD \$2.5 million, CAD \$2.5 million, and CAD \$1.6 million with settlement dates of May 14, 2012, August 16, 2012, September 27, 2012, December 20, 2012, July 11, 2013, and August 1, 2013, respectively. These non-deliverable forward contracts qualified for hedge accounting and were designated as fair value hedges in accordance with ASC 815-25 *Fair Value Hedges*. This hedge was effective in offsetting our exposure to the CAD and therefore the \$0.2 million loss on the hedge was completely offset by our \$0.2 million gain on the exposure associated with funding our semi-works facility for the three and six months ended June 30, 2012.

Net Investment Hedges. In May and June 2012, we entered into a series of non-deliverable forward contracts to protect our net investment in our European subsidiaries against adverse changes in exchange rates by fixing the U.S. dollar/Euro exchange rate. The notional amounts of these contracts were 50.3 million in May and 75.3 million in June with all contracts expiring at the end of each respective month. These non-deliverable forward contracts qualify for hedge accounting and were designated as net investment hedges in accordance with ASC 815-35 *Net Investment Hedges*. We recorded a \$1.8 million gain in accumulated other comprehensive loss related to the effective portion of settlement of the contracts.

Foreign Currency Hedges. Periodically, we enter into foreign currency agreements to hedge or otherwise protect against fluctuation in foreign currency exchange rates. These agreements typically do not qualify for hedge accounting and gains/losses resulting from both the up-front premiums and/or settlement of the hedges at expiration of the agreements are recognized in the period in which they are incurred. During the six months ended June 30, 2012, we entered into a series of foreign currency option and forward contracts to reduce our exposure to exchange rate volatility. The contracts were structured such that the underlying foreign exchange gains/losses would be offset by the mark-to-market impact of the hedging instruments and reduce the impact of foreign exchange movements throughout the period. The contracts entered into during the six months ended June 30, 2012 did not qualify for hedge accounting. In the three and six months ended June 30, 2012, we settled these hedges and recorded an aggregate gain of \$0.0 million and \$1.1 million, respectively, which offset underlying foreign exchange losses and were recorded in cost of goods sold.

Fair Value of Financial Instruments. ASC 820, *Fair Value Measurements and Disclosures* defines fair value, establishes a consistent framework for measuring fair value and expands disclosure requirements about fair value measurements. ASC 820 requires entities to, among other things, maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value.

Table of Contents

ASC 820 defines fair value as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date.

ASC 820 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect our market assumptions. In accordance with ASC 820, these two types of inputs have created the following fair value hierarchy:

Level 1 Quoted unadjusted prices for identical instruments in active markets;

Level 2 Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets; and

Level 3 Model-derived valuations in which one or more significant inputs or significant value drivers are unobservable.

The following table presents the carrying values and approximate fair values of our long-term debt as of June 30, 2012 and December 31, 2011:

	June 30, 2012		December 31, 2011	
	Carrying Value	Fair Value	Carrying Value	Fair Value
	(in thousands)			
Term Loans	\$ 138,750	\$ 138,750	\$ 142,500	\$ 142,500
6.75% unsecured notes	\$ 351,214	\$ 367,500	\$ 250,000	\$ 234,063

The term loans are variable interest rate instruments, and as such, the fair value approximates their carrying value.

The financial instruments measured at fair value on a recurring basis as of June 30, 2012 and December 31, 2011 are as follows:

Balance Sheet Location	June 30, 2012	Fair Value Measurements at Reporting Date Using Quoted Prices in Active Markets for Identical Assets (Level 1)			Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
		(in thousands)				
Derivative liability current	Other payables and accruals	\$ 702	\$ 0	\$ 702	\$ 0	
Derivative liability noncurrent	Other long-term liabilities	489	0	489	0	
Total		\$ 1,191	\$ 0	\$ 1,191	\$ 0	

Balance Sheet Location	December 31, 2011	Fair Value Measurements at Reporting Date Using Quoted Prices in Active Markets			Significant Other Observable Inputs	Significant Unobservable Inputs (Level 3)
		(in thousands)				

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		for Identical Assets (Level 1) (in thousands)		(Level 2)	
Derivative liability 2011 Interest rate swap	Other payables and accruals	\$ 434	\$ 0	\$ 434	\$ 0
Derivative liability 2011 Interest rate swap	Other long-term liabilities	375	0	375	0
Total		\$ 809	\$ 0	\$ 809	\$ 0

Table of Contents

The use of derivatives creates exposure to credit risk relating to potential losses that could be recognized in the event that the counterparties to these instruments fail to perform their obligations under the contracts. We seek to minimize this risk by limiting our counterparties to major financial institutions with acceptable credit ratings and monitoring positions with individual counterparties. In the event of a default by one of our counterparties, we may not receive payments provided for under the terms of our derivatives.

Credit Risk. Our customers are diversified by industry and geography with more than 800 customers in over 60 countries. We analyze the counterparties' financial condition prior to extending credit and we establish credit limits and monitor the appropriateness of those limits on an ongoing basis. We also obtain cash, letters of credit or other acceptable forms of security from customers to provide credit support, where appropriate, based on our financial analysis of the customer and the contractual terms and conditions applicable to each transaction.

10. Income Taxes

Our income tax expense was \$3.3 million and \$4.1 million for the three months ended June 30, 2012 and 2011, and \$6.0 million and \$6.7 million for the six months ended June 30, 2012 and 2011, respectively. Our effective tax rates were 20.9% and 8.1% for the three months ended June 30, 2012 and 2011, and 17.3% and 8.9% for the six months ended June 30, 2012 and 2011, respectively. Our effective tax rates were lower than the U.S. corporate statutory tax rate of 35.0% primarily due to the mix of pre-tax income earned in foreign jurisdictions during these periods and the partial release of our valuation allowance.

As of June 30, 2012 and 2011, a valuation allowance of \$54.0 million and \$57.6 million, respectively, has 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 three months ended June 30, 2012 and 2011, we reduced our valuation allowance on deferred tax assets by \$0.1 million and \$5.4 million, respectively. For the six months ended June 30, 2012 and 2011, we reduced our valuation allowance on deferred tax assets by \$0.2 million and \$8.4 million, respectively, as a result of our ability to realize the tax benefit of our net operating loss carryforwards in France during 2012 and the U.S. and France in 2011. Excluding the release of our valuation allowance, our effective tax rates would have been 21.6% and 18.7% for the three months ended June 30, 2012 and 2011, and 18.0% and 20.0% for the six months ended June 30, 2012 and 2011, respectively.

As of June 30, 2012, we had total unrecognized tax benefits of \$4.0 million related to uncertain foreign tax positions, all of which, if recognized, would impact the effective tax rate. During the three and six months ended June 30, 2012, we had an increase in uncertain tax positions of \$0.3 million and \$1.1 million, respectively, primarily related to uncertain tax positions in Europe. We recorded interest and penalties related to unrecognized tax benefits within the provision for income taxes. We believe that no current tax positions that have resulted in unrecognized tax benefits will significantly increase or decrease within one year.

We file income tax returns in the U.S. federal jurisdiction and in various state and foreign jurisdictions. For our U.S. federal income tax returns, the statute of limitations has expired through the tax year ended December 31, 2003. As a result of net operating loss carryforwards from 2004, the statute of limitations remains open for all years subsequent to 2003. In addition, open tax years for state and foreign jurisdictions remain subject to examination.

The Internal Revenue Service has completed its review of our 2009 U.S. federal income tax return. We do not expect the final resolution of this matter to have a material impact on our financial position or results of operations.

11. Commitments and Contingencies

Legal Proceedings. Kraton was a party to an arbitration proceeding with LyondellBasell regarding 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. The parties had been dealing with one another in

Table of Contents

accordance with the term sheet from January 2009 until LyondellBasell notified Kraton on September 9, 2010 that LyondellBasell would no longer be governed by the term sheet. Following receipt of the September 9, 2010 notice, Kraton paid an increased net amount to LyondellBasell on a monthly basis (under protest) to reflect the pre-term sheet arrangements between the parties. On March 13, 2012, Kraton and LyondellBasell reached a settlement regarding the matter, and in connection therewith entered into a series of commercial agreements and amendments to existing commercial agreements. For the six months ended June 30, 2012, we recorded a benefit of approximately \$6.8 million, on a pre-tax basis, to cost of goods sold for a refund received in the settlement of net increased payments we had been making to LyondellBasell.

In 2011, we were notified by the tax authorities in France that we owed an additional 6.9 million of property taxes related to the 2009 tax year. The tax authorities claimed that we did not timely file forms that serve to cap property taxes for 2009. We believe that all such forms were timely filed and that we were otherwise in compliance with the related applicable filing requirements. In March 2012, the tax authorities advised us of their final ruling in this matter and assessed us a final amount of 4.7 million, including penalties of 0.4 million. For the six months ended June 30, 2012, we recorded charges of approximately \$5.6 million and \$0.6 million, on a pre-tax basis, to cost of goods sold and selling, general, and administrative expenses, respectively, associated with this ruling.

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. 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. 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.

Asset Retirement Obligations. In 2011, 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 Section 112 of the Clean Air Act. The Boiler MACT rule applies to the coal-burning boilers at our Belpre, Ohio, facility.

Our asset retirement obligations were \$10.2 million as of June 30, 2012, and consists of AROs for our Belpre, Ohio, Berre, France, Wesseling, Germany and Houston, Texas (Shell Westhollow Technology Center) facilities. Approximately \$5.4 million is related to Belpre, \$1.4 million to Wesseling, \$1.9 million to Berre, and \$1.5 million to Westhollow. During the three months ended June 30, 2012, we increased our estimated costs associated with the exit activity for the Shell Westhollow Technology Center by \$0.9 million.

The changes in the aggregate carrying amount of our ARO liability are as follows:

	ARO Liability Balance (in thousands)
Balance at December 31, 2011	\$ 8,978
Accretion expense	283
Obligations settled	(8)
Revisions in estimated cash flows	923
Balance at June 30, 2012	\$ 10,176

There have been no other material changes to our Commitments and Contingencies disclosed in our most recently filed Annual Report on Form 10-K, as subsequently amended on March 8, 2012.

Table of Contents**12. Employee Benefits**

Retirement Plans. The components of net periodic benefit cost related to U.S. pension benefits are as follows:

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
	(in thousands)		(in thousands)	
Service cost	\$ 765	\$ 660	\$ 1,590	\$ 1,320
Interest cost	1,438	1,300	2,791	2,600
Expected return on plan assets	(1,493)	(1,310)	(2,991)	(2,620)
Amortization of prior service cost	735	247	1,365	494
Net periodic benefit cost	\$ 1,445	\$ 897	\$ 2,755	\$ 1,794

We made contributions of \$3.3 million and \$2.1 million to our pension plan in the six months ended June 30, 2012 and 2011, respectively. We expect total contributions to be \$10.2 million in 2012.

The components of net periodic benefit cost related to other post-retirement benefits are as follows:

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
	(in thousands)		(in thousands)	
Service cost	\$ 128	\$ 110	\$ 256	\$ 220
Interest cost	305	307	610	615
Amortization of prior service cost	150	99	300	198
Net periodic benefit cost	\$ 583	\$ 516	\$ 1,166	\$ 1,033

13. Industry Segment and Foreign Operations

We operate in one segment for the manufacturing and marketing of engineered polymers. In accordance with the provisions of ASC 280, *Segment Reporting*, our chief operating decision-maker has been identified as the President and Chief Executive Officer, who reviews operating results to make decisions about allocating resources and assessing performance for the entire company. Since we operate in one segment and in one group of similar products, all financial segment and product line information required by ASC 280 can be found in the condensed consolidated financial statements.

We manufacture our products along the following primary product lines based upon polymer chemistry and process technologies:

unhydrogenated SBCs (USBCs);

hydrogenated SBCs (HSBCs);

Cariflex isoprene rubber (IR) and isoprene rubber latex (IRL); and

compounds.

Table of Contents

Sales revenue for our four primary product lines are as follows (1):

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
	(in thousands)		(in thousands)	
USBCs	\$ 218,908	\$ 239,102	\$ 462,100	\$ 441,871
HSBCs	118,145	115,757	250,521	229,634
Cariflex	29,805	23,316	52,450	46,089
Compounds	8,666	8,253	17,114	13,662
	\$ 375,524	\$ 386,428	\$ 782,185	\$ 731,256

(1) Our product line sales revenue excludes \$0.2 million and \$1.9 million of other sales revenue in the three and six months ended June 30, 2012, respectively.

For geographic reporting, sales revenue is attributed to the geographic location in which the customers facilities are located. Long-lived assets consist primarily of property, plant, and equipment, which are attributed to the geographic location in which they are located and are presented at historical cost.

Sales revenue and long-lived assets by geographic region are as follows:

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
	(in thousands)		(in thousands)	
Sales revenue:				
United States	\$ 122,089	\$ 130,472	\$ 272,339	\$ 246,780
Germany	50,583	60,703	100,200	109,829
Japan	21,834	22,986	41,196	42,205
China	20,072	13,865	39,917	29,695
France	12,792	13,981	26,827	24,534
Brazil	11,666	12,724	25,820	24,311
Belgium	11,589	7,167	25,594	19,314
Italy	10,407	13,954	24,501	29,072
United Kingdom	11,225	13,431	23,088	22,234
Thailand	13,651	7,310	21,632	16,454
The Netherlands	7,502	12,807	20,792	20,683
Turkey	9,108	9,384	18,777	14,090
Canada	5,154	6,982	10,598	13,309
Austria	5,204	5,362	10,155	10,449
Poland	7,420	5,719	10,121	6,713
Malaysia	4,435	3,066	10,115	6,373
Taiwan	3,248	4,421	10,040	10,235
Australia	5,664	1,583	8,780	4,513
Sweden	5,396	3,731	8,706	8,386
South Korea	3,959	3,708	8,389	8,127
Argentina	2,988	3,613	7,773	6,810
Mexico	3,178	3,334	6,448	5,974
All other countries	26,592	26,125	52,261	51,167

\$ 375,756	\$ 386,428	\$ 784,069	\$ 731,256
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Table of Contents

	June 30, 2012	December 31, 2011
	(in thousands)	
Long-lived assets:		
United States	\$ 403,059	\$ 387,022
France	115,566	115,169
Brazil	77,827	81,021
Germany	47,503	47,125
The Netherlands	13,411	13,355
China	5,422	4,394
Japan	1,898	1,893
All other countries	4,249	4,436
	\$ 668,935	\$ 654,415

14. Related Party Transactions

We own a 50% equity investment in an SBC manufacturing joint venture located in Kashima, Japan.

The aggregate amounts of related-party transactions were as follows:

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
	(in thousands)		(in thousands)	
Purchases from related party	\$ 12,792	\$ 7,506	\$ 30,670	\$ 17,739

The due to related party is solely related to our commercial arrangement associated with this joint venture, which requires payment by each party within 150 days of invoice.

15. Supplemental Guarantor Information

Kraton Polymers LLC and Kraton Polymers Capital Corporation, a financing subsidiary, collectively, (the Issuers), are co-issuers of the 6.75% senior notes due March 1, 2019. Kraton Performance Polymers, Inc. and Elastomers Holdings LLC, a U.S. holding company and wholly-owned subsidiary of Kraton Polymers LLC, collectively, (the Guarantors), fully and unconditionally guarantee on a joint and several basis, the Issuers obligations under the 6.75% senior notes. Our remaining subsidiaries are not guarantors of the 6.75% senior notes. We do not believe that separate financial statements and other disclosures concerning the Guarantor Subsidiaries would provide any additional information that would be material to investors in making an investment decision.

Table of Contents**KRATON PERFORMANCE POLYMERS, INC.****CONDENSED CONSOLIDATING BALANCE SHEET****June 30, 2012****(Unaudited)****(In thousands, except par value)**

	Kraton	Kraton Polymers LLC (1)	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
ASSETS						
Current assets:						
Cash and cash equivalents	\$ 0	\$ 0	\$ 66,801	\$ 161,161	\$ 0	\$ 227,962
Receivables, net of allowances of \$507	0	242	67,327	116,165	0	183,734
Inventories of products	0	0	220,177	162,306	0	382,483
Inventories of materials and supplies	0	0	8,131	2,248	0	10,379
Deferred income taxes	0	0	1,881	391	0	2,272
Other current assets	0	6,260	899	20,404	0	27,563
Total current assets	0	6,502	365,216	462,675	0	834,393
Property, plant, and equipment, less accumulated depreciation of \$304,314	0	61,361	207,631	95,629	0	364,621
Identifiable intangible assets, less accumulated amortization of \$63,013	0	44,480	19,268	69	0	63,817
Investment in consolidated subsidiaries	568,169	1,277,264	0	0	(1,845,433)	0
Investment in unconsolidated joint venture	0	813	0	12,177	0	12,990
Debt issuance costs	0	12,386	0	0	0	12,386
Other long-term assets	0	1,615	467,138	38,987	(483,242)	24,498
Total assets	\$ 568,169	\$ 1,404,421	\$ 1,059,253	\$ 609,537	\$ (2,328,675)	\$ 1,312,705
LIABILITIES AND STOCKHOLDERS AND MEMBER S EQUITY						
Current liabilities:						
Current portion of long-term debt	\$ 0	\$ 9,375	\$ 0	\$ 0	\$ 0	\$ 9,375
Accounts payable-trade	0	1,238	46,718	63,942	0	111,898
Other payables and accruals	0	10,244	17,836	21,633	0	49,713
Due to related party	0	0	0	30,770	0	30,770
Total current liabilities	0	20,857	64,554	116,345	0	201,756
Long-term debt, net of current portion	0	480,589	0	0	0	480,589
Deferred income taxes	0	14,072	(7,330)	(1,979)	0	4,763
Other long-term liabilities	0	318,212	81,617	169,835	(483,242)	86,422
Total liabilities	0	833,730	138,841	284,201	(483,242)	773,530
Commitments and contingencies (note 11)						
Stockholders and member s equity:						
Preferred stock, \$0.01 par value; 100,000 shares authorized; none issued	0	0	0	0	0	0
Common stock, \$0.01 par value; 500,000 shares authorized; 32,240 shares issued and outstanding	322	0	0	0	0	322
Additional paid in capital	351,451	0	0	0	0	351,451
Member s equity	0	568,169	961,412	315,852	(1,845,433)	0
Retained earnings	216,396	0	0	0	0	216,396

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Accumulated other comprehensive income (loss)	0	2,522	(41,000)	9,484	0	(28,994)
Total stockholders' and member's equity	568,169	570,691	920,412	325,336	(1,845,433)	539,175
Total liabilities and stockholders' and member's equity	\$ 568,169	\$ 1,404,421	\$ 1,059,253	\$ 609,537	\$ (2,328,675)	\$ 1,312,705

- (1) Kraton Polymers LLC and Kraton Polymers Capital Corporation, a financing subsidiary, collectively, the Issuers, are co-issuers of the 6.75% senior notes due March 1, 2019. Kraton Polymers Capital Corporation has minimal assets and income. We do not believe that separate financial information concerning the Issuers would provide additional information that would be material to investors in making an investment decision.

Table of Contents**KRATON PERFORMANCE POLYMERS, INC.****CONDENSED CONSOLIDATING BALANCE SHEET****December 31, 2011****(In thousands, except par value)**

	Kraton	Kraton Polymers LLC (1)	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
ASSETS						
Current assets:						
Cash and cash equivalents	\$ 0	\$ 0	\$ 6,030	\$ 82,549	\$ 0	\$ 88,579
Receivables, net of allowances of \$549	0	0	54,905	87,791	0	142,696
Inventories of products	0	0	222,783	172,013	0	394,796
Inventories of materials and supplies	0	0	7,654	2,342	0	9,996
Deferred income taxes	0	0	1,881	259	0	2,140
Other current assets	0	3,365	344	23,619	0	27,328
Total current assets	0	3,365	293,597	368,573	0	665,535
Property, plant, and equipment, less accumulated depreciation of \$281,442	0	66,095	205,562	101,316	0	372,973
Identifiable intangible assets, less accumulated amortization of \$58,530	0	47,961	18,223	0	0	66,184
Investment in consolidated subsidiaries	535,412	1,218,793	0	0	(1,754,205)	0
Investment in unconsolidated joint venture	0	813	0	12,537	0	13,350
Debt issuance costs	0	11,106	0	0	0	11,106
Other long-term assets	0	5,451	511,452	121,961	(614,256)	24,608
Total assets	\$ 535,412	\$ 1,353,584	\$ 1,028,834	\$ 604,387	\$ (2,368,461)	\$ 1,153,756
LIABILITIES AND STOCKHOLDERS AND MEMBER S EQUITY						
Current liabilities:						
Current portion of long-term debt	\$ 0	\$ 7,500	\$ 0	\$ 0	\$ 0	\$ 7,500
Accounts payable-trade	0	841	42,252	44,933	0	88,026
Other payables and accruals	0	7,832	14,125	29,296	0	51,253
Due to related party	0	0	0	14,311	0	14,311
Total current liabilities	0	16,173	56,377	88,540	0	161,090
Long-term debt, net of current portion	0	385,000	0	0	0	385,000
Deferred income taxes	0	14,505	(7,330)	(961)	0	6,214
Other long-term liabilities	0	401,573	78,754	217,587	(614,256)	83,658
Total liabilities	0	817,251	127,801	305,166	(614,256)	635,962
Commitments and contingencies (note 11)						
Stockholders' and member's equity:						
Preferred stock, \$0.01 par value; 100,000 shares authorized; none issued	0	0	0	0	0	0
Common stock, \$0.01 par value; 500,000 shares authorized; 32,092 shares issued and outstanding	321	0	0	0	0	321
Additional paid in capital	347,455	0	0	0	0	347,455
Member's equity	0	535,412	942,032	276,761	(1,754,205)	0
Retained earnings	187,636	0	0	0	0	187,636
Accumulated other comprehensive income (loss)	0	921	(40,999)	22,460	0	(17,618)

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Total stockholders and member s equity	535,412	536,333	901,033	299,221	(1,754,205)	517,794
Total liabilities and stockholders and member s equity	\$ 535,412	\$ 1,353,584	\$ 1,028,834	\$ 604,387	\$ (2,368,461)	\$ 1,153,756

- (1) Kraton Polymers LLC and Kraton Polymers Capital Corporation, a financing subsidiary, collectively, the Issuers, are co-issuers of the 6.75% senior notes due March 1, 2019. Kraton Polymers Capital Corporation has minimal assets and income. We do not believe that separate financial information concerning the Issuers would provide additional information that would be material to investors in making an investment decision.

Table of Contents**KRATON PERFORMANCE POLYMERS, INC.****CONDENSED CONSOLIDATING STATEMENT OF INCOME**

Three months ended June 30, 2012

(Unaudited)

(In thousands)

	Kraton	Kraton Polymers LLC (1)	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Sales revenue	\$ 0	\$ 0	\$ 189,256	\$ 233,540	\$ (47,040)	\$ 375,756
Cost of goods sold	0	(29)	155,606	193,739	(47,040)	302,276
Gross profit	0	29	33,650	39,801	0	73,480
Operating expenses						
Research and development	0	0	4,827	3,169	0	7,996
Selling, general, and administrative	0	0	17,907	8,406	0	26,313
Depreciation and amortization	0	4,080	8,863	2,942	0	15,885
Total operating expenses	0	4,080	31,597	14,517	0	50,194
Earnings in consolidated subsidiaries	12,407	25,865	0	0	(38,272)	0
Earnings of unconsolidated joint venture	0	0	0	163	0	163
Interest expense (income), net	0	9,673	(3,457)	1,557	0	7,773
Income before income taxes	12,407	12,141	5,510	23,890	(38,272)	15,676
Income tax expense (benefit)	0	(266)	(902)	4,437	0	3,269
Net income	\$ 12,407	\$ 12,407	\$ 6,412	\$ 19,453	\$ (38,272)	\$ 12,407

- (1) Kraton Polymers LLC and Kraton Polymers Capital Corporation, a financing subsidiary, collectively, the Issuers, are co-issuers of the 6.75% senior notes due March 1, 2019. Kraton Polymers Capital Corporation has minimal assets and income. We do not believe that separate financial information concerning the Issuers would provide additional information that would be material to investors in making an investment decision.

Table of Contents**KRATON PERFORMANCE POLYMERS, INC.****CONDENSED CONSOLIDATING STATEMENT OF INCOME**

Three months ended June 30, 2011

(Unaudited)

(In thousands)

	Kraton	Kraton Polymers LLC (1)	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Sales revenue	\$ 0	\$ 0	\$ 195,492	\$ 232,654	\$ (41,718)	\$ 386,428
Cost of goods sold	0	(0)	140,351	179,400	(41,718)	278,033
Gross profit	0	0	55,141	53,254	0	108,395
Operating expenses						
Research and development	0	0	4,236	2,730	0	6,966
Selling, general, and administrative	0	(354)	20,154	8,112	0	27,912
Depreciation and amortization	0	4,083	8,172	3,349	0	15,604
Total operating expenses	0	3,729	32,562	14,191	0	50,482
Earnings in consolidated subsidiaries	46,977	59,696	0	0	(106,673)	0
Loss of unconsolidated joint venture	0	0	0	(880)	0	(880)
Interest expense (income), net	0	8,939	(3,918)	894	0	5,915
Income before income taxes	46,977	47,028	26,497	37,289	(106,673)	51,118
Income tax expense	0	51	0	4,090	0	4,141
Net income	\$ 46,977	\$ 46,977	\$ 26,497	\$ 33,199	\$ (106,673)	\$ 46,977

- (1) Kraton Polymers LLC and Kraton Polymers Capital Corporation, a financing subsidiary, collectively, the Issuers, are co-issuers of the 6.75% senior notes due March 1, 2019. Kraton Polymers Capital Corporation has minimal assets and income. We do not believe that separate financial information concerning the Issuers would provide additional information that would be material to investors in making an investment decision.

Table of Contents**KRATON PERFORMANCE POLYMERS, INC.****CONDENSED CONSOLIDATING STATEMENT OF INCOME**

Six months ended June 30, 2012

(Unaudited)

(In thousands)

	Kraton	Kraton Polymers LLC (1)	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Sales revenue	\$ 0	\$ 0	\$ 395,477	\$ 467,168	\$ (78,576)	\$ 784,069
Cost of goods sold	0	(1,085)	325,619	389,112	(78,576)	635,070
Gross profit	0	1,085	69,858	78,056	0	148,999
Operating expenses						
Research and development	0	0	9,713	5,843	0	15,556
Selling, general, and administrative	0	0	35,973	16,803	0	52,776
Depreciation and amortization	0	8,159	17,159	6,416	0	31,734
Total operating expenses	0	8,159	62,845	29,062	0	100,066
Earnings in consolidated subsidiaries	28,760	54,733	0	0	(83,493)	0
Earnings of unconsolidated joint venture	0	0	0	300	0	300
Interest expense (income), net	0	19,332	(7,513)	2,653	0	14,472
Income before income taxes	28,760	28,327	14,526	46,641	(83,493)	34,761
Income tax expense (benefit)	0	(433)	(1,117)	7,551	0	6,001
Net income	\$ 28,760	\$ 28,760	\$ 15,643	\$ 39,090	\$ (83,493)	\$ 28,760

- (1) Kraton Polymers LLC and Kraton Polymers Capital Corporation, a financing subsidiary, collectively, the Issuers, are co-issuers of the 6.75% senior notes due March 1, 2019. Kraton Polymers Capital Corporation has minimal assets and income. We do not believe that separate financial information concerning the Issuers would provide additional information that would be material to investors in making an investment decision.

Table of Contents**KRATON PERFORMANCE POLYMERS, INC.****CONDENSED CONSOLIDATING STATEMENT OF INCOME**

Six months ended June 30, 2011

(Unaudited)

(In thousands)

	Kraton	Kraton Polymers LLC (1)	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Sales revenue	\$ 0	\$ 0	\$ 369,648	\$ 438,731	\$ (77,123)	\$ 731,256
Cost of goods sold	0	(120)	262,310	350,943	(77,123)	536,010
Gross profit	0	120	107,338	87,788	0	195,246
Operating expenses						
Research and development	0	0	8,374	5,194	0	13,568
Selling, general, and administrative	0	(180)	38,659	16,604	0	55,083
Depreciation and amortization	0	8,236	15,452	6,542	0	30,230
Total operating expenses	0					