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Kraton Performance Polymers, Inc.
Form 10-Q
May 01, 2014

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 March 31, 2014

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
(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)

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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 April 24, 2014: 32,777,278.

Index to Quarterly Report

on Form 10-Q for

Quarter Ended March 31, 2014

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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 and other innovations; adequacy of cash flows to fund our working capital requirements; our investment in the joint venture with Formosa Petrochemical Corporation (“FPCC”); our expectations regarding indebtedness to be incurred by our joint venture with FPCC; our proposed combination with the styrenic block copolymer (“SBC”) business of LCY Chemical Corp. (“LCY”), the expectation that such combination will close in the fourth quarter of 2014 and expected synergies and other benefits therefrom and costs associated therewith; our ability to obtain a consent under the indenture governing our 6.75% senior notes in connection with our proposed combination with the SBC business of LCY; debt payments, interest payments, capital expenditures, benefit plan contributions, and income tax obligations; our anticipated 2014 capital expenditures, compliance with the MACT rule, health, safety and environmental and infrastructure and maintenance projects, projects to optimize the production capabilities of our manufacturing assets and to support our innovation platform; our ability to ensure full access to our senior secured credit facilities; expectations regarding our counterparties’ ability to perform, including with respect to trade receivables; estimates regarding the tax expense of repatriating certain cash and short-term investments related to foreign operations; expectations regarding high-margin applications; our ability to realize certain deferred tax assets and our beliefs with respect to tax positions; expectations regarding our full year effective tax rate; our plans and expectations regarding our Asia expansion project; estimates related to the useful lives of certain assets for tax purposes; expectations regarding our pension contributions for fiscal year 2014; estimates or expectations related to monomer costs, ending inventory levels and related estimated charges; the outcome and financial impact of legal proceedings; expectations regarding the spread between FIFO and ECRC in future periods; and projections regarding environmental costs and capital expenditures and related operational savings. Such forward-looking statements involve assumptions, 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. 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, 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:

the likelihood of closing the combination with LCY, which is subject to a number of material regulatory conditions; the business uncertainties and contractual restrictions that we and LCY are subject to while the proposed LCY Combination is pending, which could adversely affect each party’s business and operations;

failure to successfully combine the businesses in the expected time frame may adversely affect the future results of the combined organization, and, consequently, the value of our common stock;

failure to complete the LCY Combination, or significant delays in completing the LCY Combination, could negatively affect the trading price of our common stock and our future business and financial results;

the possibility that we may not realize the benefits we anticipate from the proposed redomestication of our company from Delaware to the United Kingdom;

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

conditions in the global economy and capital markets;
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;

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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;

significant fluctuations in raw material costs may result in volatility in our quarterly operating results and impact the market price of our common stock;

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;

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

a major failure of our information systems, which could harm our business;

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 facilities and the senior notes;

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;

we may have additional tax liabilities;

our formation of a joint venture to expand HSBC capacity in Asia;

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 could require us to materially increase future funding requirements of the pension plan;

domestic or international natural disasters or terrorist attacks may disrupt our operations;

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 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, 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.

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders

Kraton Performance Polymers, Inc.:

We have reviewed the accompanying condensed consolidated balance sheet of Kraton Performance Polymers, Inc. and subsidiaries (the Company) as of March 31, 2014, and the related condensed consolidated statements of operations, comprehensive loss, changes in equity, and cash flows for the three-month periods ended March 31, 2014 and 2013. These condensed consolidated financial statements are the responsibility of the Company's management.

We conducted our reviews in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the condensed consolidated financial statements referred to above for them to be in conformity with U.S. generally accepted accounting principles.

We have previously audited, in accordance with standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of the Company as of December 31, 2013, and the related consolidated statements of operations, comprehensive income (loss), changes in equity, and cash flows for the year then ended (not presented herein); and in our report dated February 27, 2014, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2013 is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ KPMG LLP

Houston, Texas
May 1, 2014

PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements.
KRATON PERFORMANCE POLYMERS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands, except par value)

	March 31, 2014	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	\$97,319	\$175,872
Receivables, net of allowances of \$402 and \$315	150,848	129,356
Inventories of products	343,511	328,772
Inventories of materials and supplies	11,261	10,947
Deferred income taxes	9,764	7,596
Other current assets	20,234	20,665
Total current assets	632,937	673,208
Property, plant and equipment, less accumulated depreciation of \$367,223 and \$353,428	433,817	414,257
Intangible assets, less accumulated amortization of \$81,489 and \$78,784	55,696	57,488
Investment in unconsolidated joint venture	13,721	14,074
Debt issuance costs	8,642	9,213
Deferred income taxes	1,452	1,326
Other long-term assets	25,738	25,231
Total assets	\$1,172,003	\$1,194,797
LIABILITIES AND EQUITY		
Current liabilities:		
Current portion of long-term debt	\$2,996	\$0
Accounts payable-trade	101,319	115,736
Other payables and accruals	43,256	54,539
Deferred income taxes	183	182
Due to related party	26,295	24,603
Total current liabilities	174,049	195,060
Long-term debt, net of current portion	351,975	350,989
Deferred income taxes	18,232	18,359
Other long-term liabilities	76,605	75,991
Total liabilities	620,861	640,399
Commitments and contingencies (note 10)		
Equity:		
Kraton stockholders' equity:		
Preferred stock, \$0.01 par value; 100,000 shares authorized; none issued	—	—
	328	325

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Common stock, \$0.01 par value; 500,000 shares authorized; 32,774 shares issued and outstanding at March 31, 2014; 32,547 shares issued and outstanding at December 31, 2013		
Additional paid in capital	367,307	363,590
Retained earnings	162,918	170,827
Accumulated other comprehensive loss	(19,453)	(21,252)
Total Kraton stockholders' equity	511,100	513,490
Noncontrolling interest	40,042	40,908
Total equity	551,142	554,398
Total liabilities and equity	\$1,172,003	\$1,194,797
See Notes to Condensed Consolidated Financial Statements		

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KRATON PERFORMANCE POLYMERS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In thousands, except per share data)

	Three months ended	
	March 31,	
	2014	2013
Sales revenue	\$311,656	\$340,107
Cost of goods sold	254,583	280,196
Gross profit	57,073	59,911
Operating expenses:		
Research and development	8,297	7,913
Selling, general and administrative	34,218	26,114
Depreciation and amortization	16,409	15,098
Total operating expenses	58,924	49,125
Earnings of unconsolidated joint venture	117	134
Interest expense, net	6,338	13,298
Loss before income taxes	(8,072)	(2,378)
Income tax expense	122	1,446
Consolidated net loss	(8,194)	(3,824)
Net loss attributable to noncontrolling interest	(285)	(76)
Net loss attributable to Kraton	\$(7,909)	\$(3,748)
Loss per common share:		
Basic	(0.24)	(0.12)
Diluted	(0.24)	(0.12)
Weighted average common shares outstanding:		
Basic	32,162	32,062
Diluted	32,162	32,062

See Notes to Condensed Consolidated Financial Statements.

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KRATON PERFORMANCE POLYMERS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(Unaudited)

(In thousands)

	Three months ended	
	March 31, 2014	2013
Net loss attributable to Kraton	\$(7,909)	\$(3,748)
Other comprehensive income (loss):		
Foreign currency translation adjustments, net of tax of \$0	1,799	(9,271)
Unrealized gain of interest rate swap, net of tax of \$0	—	837
Unrealized loss of net investment hedge, net of tax of \$0	—	(225)
Other comprehensive income (loss), net of tax	1,799	(8,659)
Comprehensive loss attributable to Kraton	(6,110)	(12,407)
Comprehensive income (loss) attributable to noncontrolling interest	(866)	224
Consolidated comprehensive loss	\$(6,976)	\$(12,183)

See Notes to Condensed Consolidated Financial Statements

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KRATON PERFORMANCE POLYMERS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY

(Unaudited)

(In thousands)

	Common Stock	Additional Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Kraton Stockholders' Equity	Noncontrolling Interest	Total Equity
Balance at December 31, 2012	\$ 323	\$ 354,957	\$ 171,445	\$ (34,510)	\$ 492,215	\$ —	\$ 492,215
Net loss	—	—	(3,748)	—	(3,748)	(76)	(3,824)
Other comprehensive income (loss)	—	—	—	(8,659)	(8,659)	300	(8,359)
Consolidation of variable interest entity	—	—	—	—	—	15,174	15,174
Exercise of stock options	2	308	—	—	310	—	310
Non-cash compensation related to equity awards	—	2,523	—	—	2,523	—	2,523
Balance at March 31, 2013	\$ 325	\$ 357,788	\$ 167,697	\$ (43,169)	\$ 482,641	\$ 15,398	\$ 498,039
Balance at December 31, 2013	\$ 325	\$ 363,590	\$ 170,827	\$ (21,252)	\$ 513,490	\$ 40,908	\$ 554,398
Net loss	—	—	(7,909)	—	(7,909)	(285)	(8,194)
Other comprehensive income (loss)	—	—	—	1,799	1,799	(581)	1,218
Retired treasury stock	—	(429)	—	—	(429)	—	(429)
Exercise of stock options	1	534	—	—	535	—	535
Non-cash compensation related to equity awards	2	3,612	—	—	3,614	—	3,614
Balance at March 31, 2014	\$ 328	\$ 367,307	\$ 162,918	\$ (19,453)	\$ 511,100	\$ 40,042	\$ 551,142

See Notes to Condensed Consolidated Financial Statements

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KRATON PERFORMANCE POLYMERS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	Three months ended March 31,	
	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES		
Consolidated net loss	\$(8,194)	\$(3,824)
Adjustments to reconcile consolidated net loss to net cash used in operating activities:		
Depreciation and amortization	16,409	15,098
Amortization of debt premium	(40)	(38)
Amortization of debt issuance costs	553	5,781
Gain on property, plant and equipment	(17)	(16)
Earnings from unconsolidated joint venture, net of dividends received	370	288
Deferred income tax benefit	(2,393)	(921)
Share-based compensation	3,614	2,523
Decrease (increase) in:		
Accounts receivable	(20,748)	(32,078)
Inventories of products, materials and supplies	(14,300)	(14,148)
Other assets	573	(588)
Increase (decrease) in:		
Accounts payable-trade	(24,362)	12,926
Other payables and accruals	(6,617)	(15,767)
Other long-term liabilities	582	2,196
Due to related party	983	7,794
Net cash used in operating activities	(53,587)	(20,774)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property, plant and equipment	(20,185)	(14,455)
Purchase of software and other intangibles	(1,062)	(707)
Settlement of net investment hedge	—	(2,225)
Net cash used in investing activities	(21,247)	(17,387)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from debt	—	40,000
Repayments of debt	—	(96,875)
Capital lease payments	(3,011)	(950)
Contribution from noncontrolling interest	—	15,174
Purchase of treasury stock	(429)	—
Proceeds from the exercise of stock options	535	310
Debt issuance costs	—	(3,117)
Net cash used in financing activities	(2,905)	(45,458)
Effect of exchange rate differences on cash	(814)	(3,429)
Net decrease in cash and cash equivalents	(78,553)	(87,048)

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Cash and cash equivalents, beginning of period	\$175,872	223,166
Cash and cash equivalents, end of period	\$97,319	\$136,118
Supplemental disclosures:		
Cash paid during the period for income taxes, net of refunds received	\$2,293	\$4,643
Cash paid during the period for interest, net of capitalized interest	\$11,608	\$13,639
Capitalized interest	\$636	\$961
Supplemental non-cash disclosures:		
Property, plant and equipment accruals	\$15,168	\$3,495
Asset acquired through capital lease	\$7,033	—

See Notes to Condensed Consolidated Financial Statements

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[®], Cariflex[™] and NEXAR[™] brands. 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. 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 found in many everyday applications, including personal care products such as disposable diapers and the rubberized grips of toothbrushes, razor blades and power tools. Our products are also used to impart tack and shear properties in a wide variety of adhesive products and to impart characteristics such as flexibility and durability in sealants and corrosion resistance in coatings. Our paving and roofing applications provide durability, extending road and roof life.

We also produce Cariflex isoprene rubber and isoprene rubber latex. Our Cariflex products are highly-engineered, non-SBC synthetic substitutes for natural rubber and natural rubber latex. Our Cariflex 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 have a portfolio of innovations at various stages of development and commercialization, including

polyvinyl chloride alternatives for wire and cable and medical applications;
polymers and compounds for soft skin and coated fabric applications for transportation and consumer markets;
highly-modified asphalt (“HiMA”) for high-performance paving applications;
NEXAR family of membrane polymers for water filtration, heating, ventilation, air conditioning and breathable fabrics; and
synthetic cement formulations and other oilfield applications.

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. 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.

Basis of Presentation. The accompanying unaudited condensed consolidated financial statements presented herein are for us and our consolidated subsidiaries, each of which is a wholly-owned subsidiary, except our 50% investment in our joint venture, Kraton Formosa Polymers Corporation (“KFPC”), located in Mailiao, Taiwan. KFPC is a variable interest entity for which we have determined that we are the primary beneficiary and, therefore, have consolidated into our financial statements. Our 50% investment in our joint venture located in Kashima, Japan is accounted for under the equity method of accounting. All significant intercompany transactions have been eliminated. 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, 2013 and reflect all normal recurring adjustments that are, in the opinion of management, necessary to present fairly our results of operations and financial position. Amounts reported in our Condensed Consolidated Statements of Operations 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. 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, environmental matters, asset retirement obligations (“ARO”), income tax uncertainties and other contingencies.

Income Tax in Interim Periods. We conduct operations in separate legal entities in different jurisdictions. As a result, income tax amounts are reflected in these condensed consolidated financial statements for each of those jurisdictions. Tax laws and tax rates vary substantially in these jurisdictions and are subject to change based on 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 expected 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. If we fail to achieve our operating income targets, we 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 affect our financial statements. Management does not believe that there are any other new accounting pronouncements that have been issued that may 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." 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 \$3.6 million and \$2.5 million for the three months ended March 31, 2014 and 2013, respectively. We have historically recorded these costs in selling, general and administrative expenses; however, beginning in the second quarter of 2013, a portion of these costs were recorded in cost of goods sold and research and development expenses.

4. Detail of Certain Balance Sheet Accounts

	March 31, 2014	December 31, 2013
	(In thousands)	
Inventories of products:		
Finished products	\$256,997	\$246,758
Work in progress	6,045	5,384
Raw materials	80,469	76,630
Total inventories of products	\$343,511	\$328,772
Other payables and accruals:		
Employee related	\$11,883	\$16,066
Other	31,373	38,473
Total other payables and accruals	\$43,256	\$54,539
Other long-term liabilities:		
Pension and other postretirement benefits	\$58,152	\$57,924
Other	18,453	18,067
Total other long-term liabilities	\$76,605	\$75,991
Accumulated other comprehensive loss:		
Foreign currency translation adjustments	\$24,557	\$22,758
Net unrealized loss on net investment hedge	(1,926)	(1,926)

Pension liability	(42,084)	(42,084)
Total accumulated other comprehensive loss	\$(19,453)	\$(21,252)

5. Earnings Per Share (“EPS”)

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

Diluted EPS is computed by dividing net income attributable to Kraton 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 therefore 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. Our weighted average restricted stock awards outstanding were 458,319 and 294,317 for the three months ended March 31, 2014 and 2013, respectively. For the three months ended March 31, 2014, we withheld 15,707 shares of restricted stock upon vesting to satisfy employee payroll tax withholding requirements. We immediately retired all shares withheld and the transactions were reflected in additional paid in capital in the Condensed Consolidated Statements of Changes in Equity and as a purchase of treasury stock in the Condensed Consolidated Statements of Cash Flows.

For the three months ended March 31, 2014 and 2013, the weighted average restricted share units of 66,973 and 37,921, respectively, are not included as a component of diluted EPS as they are anti-dilutive.

The weighted average performance share units of 100,861 and 20,276 are not included as a component of diluted EPS as they are anti-dilutive for the three months ended March 31, 2014 and 2013, respectively.

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 1,711,814 and 1,643,950 for the three months ended March 31, 2014 and 2013, respectively.

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

	Three months ended March 31, 2014			Three months ended March 31, 2013		
	Net Loss Attributable to Kraton (In thousands, except per share data)	Weighted Average Shares Outstanding	Loss Per Share	Net Loss Attributable to Kraton (In thousands, except per share data)	Weighted Average Shares Outstanding	Loss Per Share
Basic:						
As reported	\$ (7,909)	32,620		\$ (3,748)	32,356	
Amounts allocated to unvested restricted shares	111	(458)		34	(294)	
Amounts available to common stockholders	(7,798)	32,162	\$ (0.24)	(3,714)	32,062	\$ (0.12)
Diluted:						
Amounts allocated to unvested restricted shares	(111)	458		(34)	294	
Non participating share units	—	—		—	—	
Stock options added under the treasury stock method	—	—		—	—	
Amounts reallocated to unvested restricted shares	111	(458)		34	(294)	
Amounts available to stockholders and assumed conversions	\$ (7,798)	32,162	\$ (0.24)	\$ (3,714)	32,062	\$ (0.12)

6. Long-Term Debt

Long-term debt consists of the following:

	March 31, 2014	December 31, 2013
	(In thousands)	
6.75% unsecured notes	\$ 350,949	\$ 350,989
Capital lease obligation	4,022	—
Total debt	354,971	350,989
Less current portion of total debt	2,996	—
Long-term debt	\$ 351,975	\$ 350,989

Senior Secured Credit Facilities. In March 2013, we entered into an asset-based revolving credit facility consisting of a \$150.0 million U.S. senior secured revolving credit facility and a \$100.0 million Dutch senior secured revolving credit facility (the “Senior Secured Credit Facilities”). The Senior Secured Credit Facilities replaced our then existing senior secured credit facility, and we repaid in full all outstanding amounts payable under the previously existing indebtedness. Borrowing under the Senior Secured Credit Facilities is subject to borrowing base limitations based on the level of receivables and inventory available for security.

We may request up to an aggregate of \$100.0 million of additional revolving facility commitments of which up to an aggregate of \$40.0 million may be additional Dutch revolving facility commitments, provided that we satisfy additional conditions described in the Senior Secured Credit Facilities, and provided further that the U.S. revolver commitment is at least 60% of the commitments after giving effect to such increase.

Kraton Polymers U.S. LLC and Kraton Polymers Nederland B.V. are the borrowers under the Senior Secured Credit Facilities, and Kraton Performance Polymers, Inc., Kraton Polymers LLC, Elastomers Holdings LLC and Kraton Polymers Capital Corporation are guarantors. The Senior Secured Credit Facilities are secured by receivables and inventory. The Senior Secured Credit Facilities terminate on March 27, 2018; however, we may from time to time request that the lenders extend the maturity of their commitments. Availability under the Senior Secured Credit Facilities is limited to the lesser of the borrowing base and total commitments (less certain reserves).

U.S. borrowings under the Senior Secured Credit Facilities (other than swingline loans) bear interest at a rate equal to, at the applicable borrower’s option, either (a) a base rate determined by reference to the greater of (1) the prime rate of Bank of America, N.A., (2) the federal funds rate plus 0.50% and (3) LIBOR plus 1.0%, or (b) a rate based on LIBOR, in each case plus an applicable margin. U.S. swingline loans shall bear interest at a base rate determined by reference to the greater of (1) the prime rate of Bank of America, N.A., (2) the federal funds rate plus 0.50% or (3) LIBOR plus 1.0%, in each case plus an applicable margin.

Dutch borrowings under the Senior Secured Credit Facilities bear interest at a rate equal to, at the applicable borrower’s option, either (a) a fluctuating rate, with respect to Euros, Pounds Sterling and Dollars outside of the U.S. and Canada, equal to the rate announced by the European Central Bank and used as a base rate by the local branch of Bank of America in the jurisdiction in which such currency is funded, or (b) a rate based on LIBOR, in each case plus

an applicable margin.

The applicable margin is subject to a minimum of 0.5% and a maximum of 1.0% with respect to U.S. base rate loans, and a minimum of 1.5% and maximum of 2.0% for foreign base rate borrowings and LIBOR loans and is subject to adjustment based on the borrowers' excess availability of the applicable facility for the most recent fiscal quarter.

In addition to paying interest on outstanding principal amounts under the Senior Secured Credit Facilities, the borrowers will be required to pay a commitment fee in respect of the unutilized commitments at an annual rate of 0.375%.

The Senior Secured Credit Facilities contain a financial covenant that if either (a) excess availability is less than the greater of (i) 12.5% of the lesser of the commitments and the borrowing base and (ii) \$31,250,000 or (b) U.S. availability is less than the greater of (i) 12.5% of the lesser of the U.S. commitments and U.S. borrowing base and (ii) \$18,750,000, then following such event, Kraton and its restricted subsidiaries must maintain a fixed charge coverage ratio of at least 1.0 to 1.0 for four fiscal quarters (or for a shorter

duration if certain financial conditions are met). The Senior Secured Credit Facilities contain certain customary events of default, including, without limitation, a failure to make payments under the facility, cross-default and cross-judgment default, certain bankruptcy events and certain change of control events.

As of March 31, 2014, our available borrowing capacity was \$213.3 million of which \$0.0 million was drawn. As of the date of this filing, our available borrowing capacity was \$227.8 million, of which \$0.0 million was drawn.

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 February 11, 2011 (\$250.0 million senior notes) and supplemental indenture thereto dated 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 pay interest on the notes at 6.75% per annum, semi-annually in arrears on March 1 and September 1 of each year.

Capital Lease. In January 2014, we entered into a 10 year capital lease for a portion of the boiler MACT capital investment with a principal amount of \$7.0 million.

Debt Maturities. The remaining principal payments on our outstanding total debt as of March 31, 2014, are as follows:

	Principal Payments (In thousands)
March 31:	
2015	\$ 2,996
2016	89
2017	94
2018	100
Thereafter	350,743
Total debt	\$ 354,022

See Note 8 Fair Value Measurements, Financial Instruments and Credit Risk for fair value information related to our long-term debt.

7. 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. Amortization of debt issue costs and the accelerated write-off of debt issue costs in connection with refinancing activities are recorded as a component of interest expense. We had net debt issuance costs of \$10.9 million and \$11.4 million (of which \$2.2 million and \$2.2 million were included in other current assets) as of March 31, 2014 and December 31, 2013, respectively. In connection with the March 2013 refinancing of our indebtedness, we charged to interest expense \$5.0 million of unamortized debt issuance costs related to our previously existing indebtedness and we capitalized \$4.8 million of debt issuance costs related to our new indebtedness. We amortized \$0.6 million and

\$0.8 million, (which excludes the \$5.0 million of accelerated amortization) of debt issuance costs for the three months ended March 31, 2014 and 2013, respectively.

8. Fair Value Measurements, Financial Instruments and Credit Risk

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.

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—Inputs that are quoted prices (unadjusted) for identical assets or liabilities in active markets;
- Level 2—Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the asset or liability, including:
 - Quoted prices for similar assets or liabilities in active markets
 - Quoted prices for identical or similar assets or liabilities in markets that are not active
 - Inputs other than quoted prices that are observable for the asset or liability
 - Inputs that are derived principally from or corroborated by observable market data by correlation or other means; and
- Level 3—Inputs that are unobservable and reflect our assumptions used in pricing the asset or liability based on the best information available under the circumstances (e.g., internally derived assumptions surrounding the timing and amount of expected cash flows).

Recurring Fair Value Measurements. The following tables set forth by level within the fair value hierarchy our financial assets and liabilities that were accounted for at fair value on a recurring basis as of March 31, 2014 and December 31, 2013. These financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. Our assessment of the significance of a particular input to the fair value measurement requires judgment, which judgment may affect the valuation of their fair value and their placement within the fair value hierarchy levels.

Balance Sheet Location	March 31, 2014	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)
Retirement plan asset-noncurrent Other long-term assets	\$1,980	\$1,980	—	—

Balance Sheet Location	December 31, 2013	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)

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	2013	Active Markets for Identical Assets	Observable Inputs (Level 2)	Inputs (Level 3)
		(Level 1)		
		(In thousands)		
Retirement plan asset-noncurrent	\$ 1,908	\$ 1,908	—	—
Other long-term assets				

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 by monitoring the total value of 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.

The following table presents the carrying values and approximate fair values of our long-term debt.

	March 31, 2014		December 31, 2013	
	Carrying Value (In thousands)	Fair Value (In thousands)	Carrying Value (In thousands)	Fair Value (In thousands)
6.75% unsecured notes (quoted prices in active market for identical assets - level 1)	\$350,949	\$371,875	\$350,989	\$369,250
Capital lease obligation (significant unobservable inputs - level 2)	\$4,022	\$4,022	\$—	\$—

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 on July 15, 2011 and was set to expire on June 15, 2014. However, on March 27, 2013, in connection with the refinancing of our credit facility, we terminated and settled the interest rate swap agreement, and as a result, recognized \$0.7 million of interest expense for the three months ended March 31, 2013.

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”) against the U.S. dollar associated with the funding of certain capital expenditures. The non-deliverable forward contracts outstanding as of March 31, 2013, had notional amounts of CAD \$2.5 million and CAD \$1.6 million with settlement dates of July 11, 2013 and August 1, 2013, respectively. Due to an adjustment in the underlying payment schedule, in March 2013, we settled the hedge with a notional amount of CAD \$2.5 million with a settlement date of July 11, 2013 and entered into a new hedge with a notional value of CAD \$2.5 million with a settlement date of September 9, 2013. We also settled the hedge with the notional value of CAD \$1.6 million with a settlement date of August 1, 2013 and entered into a new hedge with a notional value of CAD \$1.6 million and a settlement date of October 8, 2013. The ineffective portion of the settlement of these hedges was immaterial. 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.” For the effective portion of these hedges, we recorded an aggregate \$0.1 million gain, which offset the \$0.1 million loss on the exposure to the CAD for the three months ended March 31, 2013.

Net Investment Hedges. During 2012, we entered into a series of non-deliverable forward and foreign currency option 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 ranged from €50.0 million to €100.0 million with all contracts expiring after thirty days. These contracts qualify for hedge accounting and were designated as net investment hedges in accordance with ASC 815-35 “Net Investment Hedges.” We recorded an aggregate \$0.2 million loss in accumulated other comprehensive loss related to the settlement of the effective portion

of the contracts during the three months ended March 31, 2013.

Foreign Currency Hedges. Periodically, we enter into foreign currency agreements to hedge or otherwise protect against fluctuations 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. The contracts are structured such that the underlying foreign currency exchange gains/losses would be offset by the mark-to-market impact of the hedging instruments and reduce the impact of foreign currency exchange movements throughout the period. These contracts did not qualify for hedge accounting. For the three months ended March 31, 2014 and 2013, we settled these hedges and recorded a loss of \$0.2 million and a loss of \$1.7 million, respectively. In all periods, the losses on settlement of these hedges offset the underlying foreign currency exchange gains recorded in cost of goods sold.

Credit Risk

We analyze our 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.

9. Income Taxes

Our income tax expense was \$0.1 million and \$1.4 million for the three months ended March 31, 2014 and 2013, respectively. Our effective tax rate was (1.5)% and (60.8)% for the three months ended March 31, 2014 and 2013, respectively. Our effective tax rates differed from the U.S. corporate statutory tax rate of 35.0%, primarily due to the mix of pre-tax income or loss earned in certain jurisdictions and the change in our valuation allowance.

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. As of March 31, 2014 and December 31, 2013, a valuation allowance of \$90.5 million and \$90.0 million, respectively, has been provided for net operating loss carryforwards and other deferred tax assets. We increased our valuation allowance by \$0.5 million for the three months ended March 31, 2014, primarily due to current period net operating losses. We increased our valuation allowance by \$7.4 million for the three months ended March 31, 2013, of which \$7.6 million represents current period net operating losses, partially offset by \$0.2 million which represents changes in other comprehensive income (loss). Excluding the change in our valuation allowance, our effective tax rate would have been 4.2% and 259.4% benefit for the three months ended March 31, 2014 and 2013, respectively.

As of March 31, 2014 and December 31, 2013, we had total unrecognized tax benefits of \$6.7 million and \$6.4 million, respectively, related to uncertain foreign tax positions, all of which, if recognized, would impact our effective tax rate. During the three months ended March 31, 2014 and 2013, we had an increase in uncertain tax positions of \$0.3 million and \$0.5 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.

10. Commitments and Contingencies

Legal Proceedings. We received notice from the tax authorities in Brazil assessing R\$5.9 million (approximately \$2.6 million converted at the March 31, 2014 exchange rate) in connection with tax credits that were generated from the purchase of certain goods which were subsequently applied by us against taxes owed. We have appealed the assertion by the tax authorities in Brazil that the goods purchased were not eligible to earn the credits. 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. 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 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.

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

	Three months ended	
	March 31, 2014	2013
	(In thousands)	
Beginning balance	\$10,497	\$9,837
Accretion expense	136	120
Obligations settled	(45)	—
Foreign currency translation, net	3	(118)
Ending Balance	\$10,591	\$9,839

Production downtime. In the first quarter of 2014 we experienced weather-related downtime at our Belpre, Ohio facility. In addition, our facility in Berre, France experienced an operating disruption resulting from a small fire which impacted one of the production lines at this facility. We incurred \$13.0 million of costs in the three months ended March 31, 2104 associated with these two events, of which \$3.7 million is included in other payables and accruals at March 31, 2014 based on management's estimates of the remaining costs to be incurred.

There have been no other material changes to our Commitments and Contingencies disclosed in our most recently filed Annual Report on Form 10-K.

11. Employee Benefits

Retirement Plans.

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

	Three months ended	
	March 31, 2014	2013
	(In thousands)	
Service cost	\$753	\$938
Interest cost	1,510	1,410
Expected return on plan assets	(1,915)	(1,655)
Amortization of prior service cost	430	1,007
Net periodic benefit cost	\$778	\$1,700

We made contributions of \$1.4 million and \$1.2 million to our pension plan in the three months ended March 31, 2014 and 2013, respectively.

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

	Three months ended	
	March 31, 2014	2013
	(In thousands)	
Service cost	\$125	\$145
Interest cost	320	292
Amortization of prior service cost	113	183
Net periodic benefit cost	\$558	\$620

12. 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:

un-hydrogenated SBCs ("USBCs");
hydrogenated SBCs ("HSBCs");
Cariflex™ isoprene rubber and isoprene rubber latex; and
compounds.

Sales revenue for our product lines is as follows:

	Three months ended	
	March 31,	
	2014	2013
	(In thousands)	
USBCs	\$165,521	\$196,773
HSBCs	103,777	108,094
Cariflex	35,363	27,029
Compounds	6,900	7,904
Other	95	307
	\$311,656	\$340,107

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	
	March 31,	
	2014	2013
	(In thousands)	
Sales revenue:		
United States	\$101,662	\$113,308
Germany	40,641	43,381
China	18,992	18,690
Japan	17,681	17,051
Thailand	16,248	9,982
Brazil	14,143	13,897
France	12,479	11,834
Italy	10,221	12,471
Belgium	8,186	10,682
United Kingdom	8,152	10,474
Netherlands	7,027	9,637
Malaysia	6,482	5,753
Taiwan	4,567	6,446
Sweden	4,425	4,073
Argentina	4,190	4,665
Canada	4,033	4,760
Mexico	3,747	4,874
Turkey	3,307	5,676
South Korea	2,941	3,223
Austria	2,815	1,726
All other countries	19,717	27,504
	\$311,656	\$340,107

	March	December
	31,	31,
	2014	2013
	(In thousands)	
Long-lived assets, at cost:		
United States	\$464,664	\$453,157
France	124,300	123,804
Brazil	79,372	76,524
Germany	64,556	64,258
Netherlands	28,563	27,865
Taiwan	30,458	12,935
China	7,175	7,226
Japan	1,733	1,696

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All other countries	219	220
	\$801,040	\$767,685

13. Related Party Transactions

We own a 50% equity investment in a SBC manufacturing joint venture with JSR Corporation (“JSR”) under the name of Kraton JSR Elastomers K.K. (“KJE”) located in Kashima, Japan. We and JSR separately, but with equal rights, participate in distributions in the sales of the thermoplastic rubber produced by KJE.

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

	Three months ended	
	March 31, 2014	2013
	(In thousands)	
Purchases from related party	\$ 13,787	\$ 12,671

Our due to related party is solely related to our commercial arrangement associated with KJE, which requires payment by each party within 150 days of invoice.

14. Variable Interest Entity

The following table summarizes the carrying amounts of assets and liabilities as of March 31, 2014 and December 31, 2013 for Kraton Formosa Polymers Corporation, our 50/50 joint venture with Formosa Petrochemical Corporation, before intercompany eliminations.

	March 31, 2014	December 31, 2013
	(In thousands)	
Cash and cash equivalents	54,690	66,816
Other current assets	386	256
Property, plant and equipment	30,425	12,912
Intangible assets	9,948	10,094
Other long-term assets	574	462
Total assets	\$96,023	\$ 90,540
Current liabilities	15,940	8,724
Total liabilities	\$ 15,940	\$ 8,724

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.

KRATON PERFORMANCE POLYMERS, INC.

CONDENSED CONSOLIDATING BALANCE SHEET

March 31, 2014

(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	\$—	\$ 6	\$ 936	\$ 96,377	\$—	\$ 97,319
Receivables, net of allowances of \$402	—	380	56,467	94,001	—	150,848
Inventories of products	—	13	192,991	150,507	—	343,511
Inventories of materials and supplies	—	—	9,128	2,133	—	11,261
Deferred income taxes	—	—	3,953	5,811	—	9,764
Other current assets	—	4,103	772	15,359	—	20,234
Total current assets	—	4,502	264,247	364,188	—	632,937
Property, plant and equipment, less accumulated depreciation of \$367,223	—	53,378	237,729	142,710	—	433,817
Intangible assets, less accumulated amortization of \$81,489	—	51,080	4,616	0	—	55,696
Investment in consolidated subsidiaries	530,553	1,319,720	—	—	(1,850,273)	—
Investment in unconsolidated joint venture	—	813	—	12,908	—	13,721
Debt issuance costs	—	5,675	1,730	1,237	—	8,642
Deferred income taxes	—	510	—	942	—	1,452
Other long-term assets	—	189	542,403	74,588	(591,442)	25,738
Total assets	\$ 530,553	\$ 1,435,867	\$ 1,050,725	\$ 596,573	\$ (2,441,715)	\$ 1,172,003
LIABILITIES AND STOCKHOLDERS' AND						
MEMBER'S EQUITY						
Current liabilities:						
Current portion of long-term debt	\$—	\$—	\$ 2,996	\$—	\$—	\$ 2,996
Accounts payable-trade	—	1,875	33,050	66,394	—	101,319
Other payables and accruals	—	15,703	12,439	15,114	—	43,256

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Deferred income taxes	—	—	—	183	—	183
Due to related party	—	—	—	26,295	—	26,295
Total current liabilities	—	17,578	48,485	107,986	—	174,049
Long-term debt, net of current portion	—	350,949	1,026	—	—	351,975
Deferred income taxes	—	10,032	3,952	4,248	—	18,232
Other long-term liabilities	—	527,564	64,516	75,967	(591,442)	76,605
Total liabilities	—	906,123	117,979	188,201	(591,442)	620,861
Commitments and contingencies (note 10)						
Stockholders' and member's equity:						
Preferred stock, \$0.01 par value; 100,000 shares authorized; non issued	—	—	—	—	—	—
Common stock, \$0.01 par value; 500,000 shares authorized; 32,774 shares issued and outstanding	328	—	—	—	—	328
Additional paid in capital	367,307	—	—	—	—	367,307
Member's equity	—	530,553	968,721	350,999	(1,850,273)	—
Retained earnings	162,918	—	—	—	—	162,918
Accumulated other comprehensive income (loss)	—	(809)	(35,975)	17,331	—	(19,453)
Kraton stockholders' and member's equity	530,553	529,744	932,746	368,330	(1,850,273)	511,100
Noncontrolling interest	—	—	—	40,042	—	40,042
Total stockholders' and member's equity	530,553	529,744	932,746	408,372	(1,850,273)	551,142
Total liabilities and stockholders' and member's equity	\$ 530,553	\$ 1,435,867	\$ 1,050,725	\$ 596,573	\$ (2,441,715)	\$ 1,172,003

(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.

KRATON PERFORMANCE POLYMERS, INC.

CONDENSED CONSOLIDATING BALANCE SHEET

December 31, 2013

(In thousands, except par value)

	Kraton	Kraton Polymers LLC (1)	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
ASSETS						
Current assets:						
Cash and cash equivalents	\$—	\$—	\$ 11,792	\$ 164,080	\$—	\$ 175,872
Receivables, net of allowances of \$315	—	80	45,971	83,305	—	129,356
Inventories of products	—	—	176,823	151,949	—	328,772
Inventories of materials and supplies	—	—	8,898	2,049	—	10,947
Deferred income taxes	—	—	3,952	3,644	—	7,596
Other current assets	—	2,071	1,541	17,053	—	20,665
Total current assets	—	2,151	248,977	422,080	—	673,208
Property, plant and equipment, less accumulated depreciation of \$353,428	—	47,157	241,650	125,450	—	414,257
Intangible assets, less accumulated amortization of \$78,784	—	34,208	23,280	—	—	57,488
Investment in consolidated subsidiaries	534,742	1,325,811	—	—	(1,860,553)	—
Investment in unconsolidated joint venture	—	813	—	13,261	—	14,074
Debt issuance costs	—	6,000	1,874	1,339	—	9,213
Deferred income taxes	—	536	—	790	—	1,326
Other long-term assets	—	612	563,305	108,393	(647,079)	25,231
Total assets	\$ 534,742	\$ 1,417,288	\$ 1,079,086	\$ 671,313	\$ (2,507,632)	\$ 1,194,797
LIABILITIES AND STOCKHOLDERS' AND MEMBER'S EQUITY						
Current liabilities:						
Accounts payable-trade	\$—	\$ 104	\$ 48,259	\$ 67,373	\$—	\$ 115,736
Other payables and accruals	—	7,875	25,970	20,694	—	54,539
Deferred income taxes	—	—	—	182	—	182
Due to related party	—	—	—	24,603	—	24,603
Total current liabilities	—	7,979	74,229	112,852	—	195,060
Long-term debt, net of current portion	—	350,989	—	—	—	350,989

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Deferred income taxes	—	10,553	3,953	3,853	—	18,359
Other long-term liabilities	—	513,560	64,394	145,116	(647,079)	75,991
Total liabilities	—	883,081	142,576	261,821	(647,079)	640,399
Commitments and contingencies (note 10)						
Stockholders' and member's equity:						
Preferred stock, \$0.01 par value; 100,000 shares authorized; non issued	—	—	—	—	—	—
Common stock, \$0.01 par value; 500,000 shares authorized; 32,547 shares issued and outstanding	325	—	—	—	—	325
Additional paid in capital	363,590	—	—	—	—	363,590
Member's equity	—	534,742	972,485	353,326	(1,860,553)	—
Retained earnings	170,827	—	—	—	—	170,827
Accumulated other comprehensive income (loss)	—	(535)	(35,975)	15,258	—	(21,252)
Kraton stockholders' and member's equity	534,742	534,207	936,510	368,584	(1,860,553)	513,490
Noncontrolling interest	—	—	—	40,908	—	40,908
Total stockholders' and member's equity	534,742	534,207	936,510	409,492	(1,860,553)	554,398
Total liabilities and stockholders' and member's equity	\$ 534,742	\$ 1,417,288	\$ 1,079,086	\$ 671,313	\$ (2,507,632)	\$ 1,194,797

(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.

KRATON PERFORMANCE POLYMERS, INC.

CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS

Three months ended March 31, 2014

(Unaudited)

(In thousands)

	Kraton	Kraton Polymers LLC (1)	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Sales revenue	\$—	\$ —	\$ 156,838	\$ 191,192	\$ (36,374)	\$ 311,656
Cost of goods sold	—	(15,114)	127,201	178,870	(36,374)	254,583
Gross profit	—	15,114	29,637	12,322	—	57,073
Operating expenses:						
Research and development	—	4,499	454	3,344	—	8,297
Selling, general and administrative	—	26,696	88	7,434	—	34,218
Depreciation and amortization	—	5,537	7,171	3,701	—	16,409
Total operating expenses	—	36,732	7,713	14,479	—	58,924
Earnings (loss) in consolidated subsidiaries	(8,194)	19,185	—	—	(10,991)	—
Earnings of unconsolidated joint venture	—	—	—	117	—	117
Interest expense (income), net	—	6,255	125	(42)	—	6,338
Income (loss) before income taxes	(8,194)	(8,688)	21,799	(1,998)	(10,991)	(8,072)
Income tax expense (benefit)	—	(494)	3	613	—	122
Consolidated net income (loss)	(8,194)	(8,194)	21,796	(2,611)	(10,991)	(8,194)
Net loss attributable to noncontrolling interest	—	—	—	(285)	—	(285)
Net income (loss) attributable to Kraton	\$(8,194)	\$(8,194)	\$ 21,796	\$ (2,326)	\$(10,991)	\$(7,909)

(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.

KRATON PERFORMANCE POLYMERS, INC.

CONDENSED CONSOLIDATING STATEMENT OF OPERATIONS

Three months ended March 31, 2013

(Unaudited)

(In thousands)

	Kraton	Kraton Polymers LLC (1)	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Sales revenue	\$—	\$ —	\$ 177,582	\$ 203,551	\$ (41,026)	\$ 340,107
Cost of goods sold	—	1,733	148,119	171,370	(41,026)	280,196
Gross profit (loss)	—	(1,733)	29,463	32,181	—	59,911
Operating expenses:						
Research and development	—	—	4,343	3,570	—	7,913
Selling, general and administrative	—	2	18,971	7,141	—	26,114
Depreciation and amortization	—	4,079	7,534	3,485	—	15,098
Total operating expenses	—	4,081	30,848	14,196	—	49,125
Earnings (loss) in consolidated subsidiaries	(3,824)	17,786	—	—	(13,962)	—
Earnings of unconsolidated joint venture	—	—	—	134	—	134
Interest expense (income), net	—	15,890	(3,576)	984	—	13,298
Income (loss) before income taxes	(3,824)	(3,918)	2,191	17,135	(13,962)	(2,378)
Income tax expense (benefit)	—	(94)	11	1,529	—	1,446
Consolidated net income (loss)	(3,824)	(3,824)	2,180	15,606	(13,962)	(3,824)
Net loss attributable to noncontrolling interest	—	—	—	(76)	—	(76)
Net income (loss) attributable to Kraton	\$(3,824)	\$(3,824)	\$ 2,180	\$ 15,682	\$(13,962)	\$(3,748)

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KRATON PERFORMANCE POLYMERS, INC.

CONDENSED CONSOLIDATING STATEMENT OF COMPREHENSIVE INCOME (LOSS)

Three months ended March 31, 2014

(Unaudited)

(In thousands)

	Kraton	Kraton Polymers LLC ⁽¹⁾	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net income (loss) attributable to Kraton	\$(8,194)	\$ (8,194)	\$ 21,796	\$ (2,326)	\$ (10,991)	\$ (7,909)
Other comprehensive income (loss):						
Foreign currency translation adjustments, net of tax of \$0	—	(274)	—	2,073	—	1,799
Other comprehensive income (loss), net of tax	—	(274)	—	2,073	—	1,799
Comprehensive income (loss) attributable to Kraton	(8,194)	(8,468)	21,796	(253)	(10,991)	(6,110)
Comprehensive loss attributable to noncontrolling interest	—	—	—	(866)	—	(866)
Consolidated comprehensive income (loss)	\$(8,194)	\$ (8,468)	\$ 21,796	\$ (1,119)	\$ (10,991)	\$ (6,976)

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KRATON PERFORMANCE POLYMERS, INC.

CONDENSED CONSOLIDATING STATEMENT OF COMPREHENSIVE INCOME (LOSS)

Three months ended March 31, 2013

(Unaudited)

(In thousands)

	Kraton	Kraton Polymers LLC ⁽¹⁾	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Net income (loss) attributable to Kraton	\$(3,824)	\$ (3,824)	\$ 2,180	\$ 15,682	\$ (13,962)	\$ (3,748)
Other comprehensive income (loss):						
Foreign currency translation adjustments, net of tax of \$0	—	(106)	—	(9,165)	—	(9,271)
Unrealized gain of interest rate swap, net of tax of \$0	—	837	—	—	—	837
Unrealized loss of net investment hedge, net of tax of \$0	—	(225)	—	—	—	(225)
Other comprehensive income (loss), net of tax	—	506	—	(9,165)	—	(8,659)
Comprehensive income (loss) attributable to Kraton	(3,824)	(3,318)	2,180	6,517	(13,962)	(12,407)
Comprehensive income attributable to noncontrolling interest	—	—	—	224	—	224
Consolidated comprehensive income (loss)	\$(3,824)	\$ (3,318)	\$ 2,180	\$ 6,741	\$ (13,962)	\$ (12,183)

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KRATON PERFORMANCE POLYMERS, INC.

CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS

Three months ended March 31, 2014

(Unaudited)

(In thousands)

	Kraton	Kraton Polymers LLC (1)	Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
Cash flows provided by (used in) operating activities	\$—	\$ (2,567)	\$ 7,997	\$ (59,017)	\$ —	\$ (53,587)
Cash flows provided by (used in) investing activities:						
Proceeds from intercompany loans	—	3,100	—	—	(3,100)	—
Purchase of property, plant and equipment	—	—	(12,313)	(7,872)	—	(20,185)
Purchase of software and other intangibles	—	(1,062)	—	—	—	(1,062)
Net cash provided by (used in) investing activities	—	2,038	(12,313)	(7,872)	(3,100)	(21,247)
Cash flows provided by (used in) financing activities:						
Capital lease payments	—	—	(3,011)	—	—	(3,011)
Purchase of treasury stock	(429)	—	—	—	—	(429)
Cash contributions from member	—	—	(429)	—	429	—
Cash distributions to member	(106)	535	—	—	(429)	—
Proceeds from the exercise of stock options	535	—	—	—	—	535
Payments on intercompany loans	—	—	(3,100)	—	3,100	—
Net cash provided by (used in) financing activities	—	535	(6,540)	—	3,100	(2,905)
Effect of exchange rate differences on cash	—	—	—	(814)	—	(814)
Net increase (decrease) in cash and cash equivalents	—	6	(10,856)	(67,703)	—	(78,553)
Cash and cash equivalents, beginning of period	—	—	11,792	164,080	—	175,872
Cash and cash equivalents, end of period	\$—	\$ 6	\$ 936	\$ 96,377	\$ —	\$ 97,319

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KRATON PERFORMANCE POLYMERS, INC.

CONDENSED CONSOLIDATING STATEMENT OF CASH FLOWS

Three months ended March 31, 2013

(Unaudited)

(In thousands)

	Kraton Polymers LLC		Guarantor Subsidiaries	Non-Guarantor Subsidiaries	Eliminations	Consolidated
	Kraton (1)					
Cash flows provided by (used in) operating activities	\$ —	\$ 34,273	\$ (99,572)	\$ 44,525	\$ —	\$ (20,774)
Cash flows provided by (used in) investing activities:						
Repayments of intercompany loans	—	64,517	—	—	(64,517)	—
Purchase of property, plant and equipment	—	—	(4,060)	(10,395)	—	(14,455)
Purchase of software and other intangibles	—	—	(641)	(66)	—	(707)
Settlement of net investment hedge	—	(2,225)	—	—	—	—