

Kraton Performance Polymers, Inc.  
Form 10-K/A  
March 31, 2010  
[Index to Financial Statements](#)

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-K /A**  
**Amendment No. 1**

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

For the fiscal year ended December 31, 2009 or

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

Commission file number

333-123749

**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)

**20-0411521**  
(I.R.S. Employer  
Identification No.)

**15710 John F. Kennedy Blvd, Suite 300**

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

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

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

**Title of Each Class**  
Common Stock, par value \$0.01

**Name of Each Exchange on Which Registered**  
New York Stock Exchange

**Securities registered pursuant to Section 12(g) of the Act: None**

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

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

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

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

Large accelerated filer:  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

Estimated aggregate market value of the common equity held by nonaffiliates of Kraton Performance Polymers, Inc. June 30, 2009: \$0.

Number of shares of Kraton Performance Polymers, Inc. Common Stock, \$0.01 par value, outstanding at February 23, 2010: 30,726,403.

**DOCUMENTS INCORPORATED BY REFERENCE**

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Portions of Kraton Performance Polymers, Inc.'s proxy statement for the 2010 Annual Meeting of Shareholders are incorporated by reference in Part III.

**Index to Financial Statements**

**Explanatory Note**

We are filing this Amendment No. 1 to our Annual Report on Form 10-K for the year ended December 31, 2009, which was filed with the U.S. Securities and Exchange Commission on March 15, 2010, or the Original Filing. The sole purpose of this Amendment No. 1 is to provide selected quarterly financial data required by Item 302 of Regulation S-K that was omitted from the Original Filing, which is included below under Item 8 Financial Statements and Supplementary Data. Pursuant to Rule 12b-15 promulgated under the Securities Exchange Act of 1934, as amended, we have reattached our financial statements as exhibits to this Amendment No. 1. However, we have made no changes to our financial statements or to the Original Filing other than the correction noted above. Except as expressly set forth above, this Amendment No. 1 does not, and does not purport to, amend or restate the information in any other item of the Original Filing.

**Index to Financial Statements****PART II****Item 8. Financial Statements and Supplementary Data.**

The financial statements are set forth herein commencing on page F-3 of this report.

**Selected Quarterly Financial Data (Unaudited)**

The following table sets forth a summary of Kraton Performance Polymers, Inc.'s quarterly financial information for each of the four quarters ended December 31, 2009 and December 31, 2008:

|  | First<br>Quarter <sup>(1)</sup> | Second<br>Quarter <sup>(2)</sup> | Third<br>Quarter <sup>(3)</sup> | Fourth<br>Quarter <sup>(4)(5)</sup> | Total        |
|--|---------------------------------|----------------------------------|---------------------------------|-------------------------------------|--------------|
| (In thousands, except per share data)      |                                 |                                  |                                 |                                     |              |
| <b>2009</b>                                |                                 |                                  |                                 |                                     |              |
| Operating revenues                         | \$ 184,957                      | \$ 243,821                       | \$ 288,518                      | \$ 250,708                          | \$ 968,004   |
| Gross profit                               | 8,934                           | 35,761                           | 69,969                          | 60,868                              | 175,532      |
| Operating income                           | (26,849)                        | 96                               | 28,135                          | 6,683                               | 8,065        |
| Net income (loss)                          | (16,461)                        | (4,178)                          | 21,865                          | (1,516)                             | (290)        |
| Earnings (loss) per common share           |                                 |                                  |                                 |                                     |              |
| Basic                                      | (0.85)                          | (0.22)                           | 1.13                            | (0.07)                              | (0.01)       |
| Diluted                                    | (0.85)                          | (0.22)                           | 1.12                            | (0.07)                              | (0.01)       |
| Weighted average common shares outstanding |                                 |                                  |                                 |                                     |              |
| Basic                                      | 19,407                          | 19,410                           | 19,433                          | 21,111                              | 19,844       |
| Diluted                                    | 19,407                          | 19,410                           | 19,496                          | 21,111                              | 19,844       |
| <b>2008</b>                                |                                 |                                  |                                 |                                     |              |
| Operating revenues                         | \$ 266,861                      | \$ 345,369                       | \$ 382,167                      | \$ 231,636                          | \$ 1,226,033 |
| Gross profit                               | 48,785                          | 62,546                           | 94,448                          | 48,971                              | 254,750      |
| Operating income (loss)                    | 760                             | 22,124                           | 47,308                          | 2,916                               | 73,108       |
| Net income (loss)                          | (9,413)                         | 10,213                           | 34,614                          | (6,995)                             | 28,419       |
| Earnings (loss) per common share           |                                 |                                  |                                 |                                     |              |
| Basic                                      | (0.49)                          | 0.53                             | 1.78                            | (0.36)                              | 1.46         |
| Diluted                                    | (0.49)                          | 0.53                             | 1.77                            | (0.36)                              | 1.46         |
| Weighted average common shares outstanding |                                 |                                  |                                 |                                     |              |
| Basic                                      | 19,390                          | 19,406                           | 19,415                          | 19,413                              | 19,406       |
| Diluted                                    | 19,390                          | 19,448                           | 19,511                          | 19,413                              | 19,483       |

- (1) During the first quarter of 2009, we recorded a gain of \$19.5 million associated with the purchase and retirement of a portion of the 8.125% senior subordinated notes, which is included in Gain on Extinguishment of Debt.
- (2) During the second quarter of 2009, we recorded a gain of \$4.3 million associated with the purchase and retirement of a portion of the 8.125% senior subordinated notes, which is included in Gain on Extinguishment of Debt.
- (3) During the third quarter of 2009, we recorded restructuring costs of \$6.0 million and a \$1.1 million non-cash charge to write-down our inventory of spare-parts associated with the shutdown and exit from the Pernis, the Netherlands facilities, which are included in Cost of Goods Sold.
- (4) During the fourth quarter of 2009, we recorded one-time accelerated depreciation of \$14.3 million associated with the shutdown and exit from the Pernis, the Netherlands facilities, which is included in Depreciation and amortization of identifiable intangibles.
- (5) During the fourth quarter of 2008, we recorded a lower-of-cost-or-market adjustment for inventory of \$8.1 million, which is included in Cost of Goods Sold.

Basic and diluted earnings per share are computed independently for each of the quarters presented. Therefore, the sum of quarterly basic and diluted per share information may not equal annual basic and diluted earnings per share.

**Index to Financial Statements**

**PART IV**

**Item 15. Exhibits and Financial Statement Schedules.**

(a) 1. Financial Statements

The following financial statements are included in Item 8:

Kraton Performance Polymers, Inc.

- (i) Report of KPMG LLP, Independent Registered Public Accounting Firm
- (ii) Consolidated Balance Sheets as of December 31, 2009 and 2008
- (iii) Consolidated Statements of Operations years ended December 31, 2009, 2008 and 2007
- (iv) Consolidated Statements of Changes in Stockholders' and Members' Equity and Comprehensive Income (Loss) years ended December 31, 2009, 2008 and 2007
- (v) Consolidated Statements of Cash Flows years ended December 31, 2009, 2008 and 2007
- (vi) Notes to consolidated financial statements

2. Exhibits

The exhibits listed on the accompanying Exhibit Index are filed as part of this Amendment No. 1 on Form 10-K/A or incorporated herein by reference.

(b) Exhibits

See Item 15(a) 2 above.

(c) Financial Statement Schedule

See Schedule II.

Index to Financial Statements

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: March 31, 2010

**Kraton Performance Polymers, Inc.**

/s/ KEVIN M. FOGARTY  
**Kevin M. Fogarty**

**President and Chief Executive Officer**

This report has been signed below by the following persons on behalf of the registrant and in the capacities indicated on March 31, 2010.

| <b>Signature</b>   | <b>Title</b>  |
|--|---|
| /s/ KEVIN M. FOGARTY<br><b>Kevin M. Fogarty</b>            | President, Chief Executive Officer and a Director (Principal Executive Officer) |
| /s/ STEPHEN E. TREMBLAY<br><b>Stephen E. Tremblay</b>      | Vice President and Chief Financial Officer<br>(Principal Financial Officer)     |
| /s/ LOUIS A. VITALE<br><b>Louis A. Vitale</b>              | Controller (Chief Accounting Officer)   |
| /s/ DAN F. SMITH*<br><b>Dan F. Smith</b>                   | Director and Chairman of the Board of Directors                                 |
| /s/ BARRY J. GOLDSTEIN*<br><b>Barry J. Goldstein</b>       | Director and Chairman of the Audit Committee                                    |
| /s/ KELVIN L. DAVIS*<br><b>Kelvin L. Davis</b>             | Director  |
| /s/ MICHAEL G. MACDOUGALL*<br><b>Michael G. MacDougall</b> | Director  |
| /s/ NATHAN H. WRIGHT*<br><b>Nathan H. Wright</b>           | Director  |
| /s/ TIMOTHY J. WALSH*<br><b>Timothy J. Walsh</b>           | Director  |

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**Timothy J. Walsh**

/s/ KEVIN G. O BRIEN\*

Director

**Kevin G. O Brien**



**Index to Financial Statements**

/s/ STEVEN J. DEMETRIOU\* Director

**Steven J. Demetriou**

/s/ RICHARD C. BROWN\* Director

**Richard C. Brown**

/s/ KAREN A. TWITCHELL\* Director

**Karen A. Twitchell**

\*By: /s/ STEPHEN E. TREMBLAY  
**Stephen E. Tremblay**

**As attorney-in-fact**

**Index to Financial Statements**

**KRATON PERFORMANCE POLYMERS, INC.**

**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

|   | <b>Page</b> |
|---|-------------|
| <b>Audited Consolidated Financial Statements</b>  |             |
| <u>Report of Independent Registered Public Accounting Firm</u>  | F-2         |
| <u>Consolidated Balance Sheets as of December 31, 2009 and 2008</u>   | F-3         |
| <u>Consolidated Statements of Operations for Years Ended December 31, 2009, 2008 and 2007</u>   | F-4         |
| <u>Consolidated Statements of Changes in Stockholders' and Member's Equity and Comprehensive Income (Loss) for Years Ended December 31, 2009, 2008 and 2007</u> | F-5         |
| <u>Consolidated Statements of Cash Flows for Years Ended December 31, 2009, 2008 and 2007</u>   | F-6         |
| <u>Notes to Consolidated Financial Statements</u>   | F-7         |

**Index to Financial Statements**

**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Stockholders

Kraton Performance Polymers, Inc.:

We have audited the accompanying consolidated balance sheets of Kraton Performance Polymers, Inc. (formerly Polymer Holdings LLC) and subsidiaries as of December 31, 2009 and 2008, and the related consolidated statements of operations, changes in stockholders' and members' equity and comprehensive income (loss), and cash flows for each of the years in the three-year period ended December 31, 2009. These consolidated financial statements are the responsibility of Kraton Performance Polymers, Inc.'s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Kraton Performance Polymers, Inc. and subsidiaries as of December 31, 2009 and 2008, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2009, in conformity with U.S. generally accepted accounting principles.

/s/ KPMG LLP

Houston, Texas

March 15, 2010

F-2

**Index to Financial Statements****KRATON PERFORMANCE POLYMERS, INC.****CONSOLIDATED BALANCE SHEETS****(In thousands, except par value)**

|   | <b>December 31,<br/>2009</b> | <b>December 31,<br/>2008</b> |
|---|------------------------------|------------------------------|
| <b>ASSETS</b>   |                              |                              |
| <b>Current Assets</b>   |                              |                              |
| Cash and cash equivalents   | \$ 69,291                    | \$ 101,396                   |
| Receivables, net of allowances of \$1,335 and \$2,512   | 115,329                      | 95,443                       |
| Inventories of products, net  | 284,258                      | 324,193                      |
| Inventories of materials and supplies, net  | 10,862                       | 11,055                       |
| Deferred income taxes   | 3,107                        | 14,778                       |
| Other current assets  | 16,770                       | 6,769                        |
| <b>Total current assets</b>   | <b>499,617</b>               | <b>553,634</b>               |
| Property, plant and equipment, less accumulated depreciation of \$236,558 and \$182,252         | 354,860                      | 372,008                      |
| Identifiable intangible assets, less accumulated amortization of \$42,741 and \$36,169          | 75,801                       | 67,051                       |
| Investment in unconsolidated joint venture  | 12,078                       | 12,371                       |
| Deferred financing costs  | 7,318                        | 8,184                        |
| Other long-term assets  | 24,825                       | 18,626                       |
| <b>Total Assets</b>   | <b>\$ 974,499</b>            | <b>\$ 1,031,874</b>          |
| <b>LIABILITIES AND STOCKHOLDERS AND MEMBER S EQUITY</b>   |                              |                              |
| <b>Current Liabilities</b>  |                              |                              |
| Current portion of long-term debt   | \$ 2,304                     | \$ 3,343                     |
| Accounts payable-trade  | 93,494                       | 75,177                       |
| Other payables and accruals   | 68,271                       | 69,349                       |
| Due to related party  | 19,006                       | 25,585                       |
| <b>Total current liabilities</b>  | <b>183,075</b>               | <b>173,454</b>               |
| Long-term debt, net of current portion  | 382,675                      | 571,973                      |
| Deferred income taxes   | 13,488                       | 34,954                       |
| Long-term liabilities   | 46,477                       | 63,117                       |
| <b>Total Liabilities</b>  | <b>625,715</b>               | <b>843,498</b>               |
| <b>Commitments and contingencies (note 8)</b>   |                              |                              |
| <b>Stockholders and Member s equity</b>   |                              |                              |
| Preferred stock, \$0.01 par value; 100,000 shares authorized; none issued                       |                              |                              |
| Common stock, \$0.01 par value; 500,000 shares authorized; 29,709 shares issued and outstanding | 297                          |                              |
| Additional paid in capital  | 311,665                      |                              |
| Member s equity   |                              | 182,553                      |
| Retained earnings   | (14)                         |                              |
| Accumulated other comprehensive income  | 36,836                       | 5,823                        |
| <b>Total stockholders and member s equity</b>   | <b>348,784</b>               | <b>188,376</b>               |
| <b>Total Liabilities and Stockholders and Member s Equity</b>                                   | <b>\$ 974,499</b>            | <b>\$ 1,031,874</b>          |

See Notes to Consolidated Financial Statements

F-3

Index to Financial Statements

## KRATON PERFORMANCE POLYMERS, INC.

## CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

|   | Years ended December 31, |              |              |
|---|--------------------------|--------------|--------------|
|   | 2009                     | 2008         | 2007         |
| <b>Operating Revenues</b>                                 |                          |              |              |
| Sales   | \$ 920,362               | \$ 1,171,253 | \$ 1,066,044 |
| Other   | 47,642                   | 54,780       | 23,543       |
| Total operating revenues                                  | 968,004                  | 1,226,033    | 1,089,587    |
| <b>Cost of Goods Sold</b>                                 | 792,472                  | 971,283      | 938,556      |
| <b>Gross Profit</b>                                       | 175,532                  | 254,750      | 151,031      |
| <b>Operating Expenses</b>                                 |                          |              |              |
| Research and development                                  | 21,212                   | 27,049       | 24,865       |
| Selling, general and administrative                       | 79,504                   | 101,431      | 69,020       |
| Depreciation and amortization of identifiable intangibles | 66,751                   | 53,162       | 51,917       |
| Total operating expenses                                  | 167,467                  | 181,642      | 145,802      |
| <b>Gain on Extinguishment of Debt</b>                     | 23,831                   |              |              |
| <b>Equity in Earnings of Unconsolidated Joint Venture</b> | 403                      | 437          | 626          |
| <b>Interest Expense, net</b>                              | 33,956                   | 36,695       | 43,484       |
| <b>Income (Loss) Before Income Taxes</b>                  | (1,657)                  | 36,850       | (37,629)     |
| <b>Income Tax Expense (Benefit)</b>                       | (1,367)                  | 8,431        | 6,120        |
| <b>Net Income (Loss)</b>                                  | \$ (290)                 | \$ 28,419    | \$ (43,749)  |
| <b>Earnings (Loss) per common share</b>                   |                          |              |              |
| Basic   | \$ (0.01)                | \$ 1.46      | \$ (2.26)    |
| Diluted   | \$ (0.01)                | \$ 1.46      | \$ (2.26)    |
| <b>Weighted average common shares outstanding</b>         |                          |              |              |
| Basic   | 19,844                   | 19,406       | 19,375       |
| Diluted   | 19,844                   | 19,483       | 19,375       |

See Notes to Consolidated Financial Statements

Index to Financial Statements

## KRATON PERFORMANCE POLYMERS, INC.

## CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS AND MEMBER S EQUITY AND COMPREHENSIVE INCOME (LOSS)

(In thousands)

|   | Common<br>Stock | Additional<br>Paid in<br>Capital | Retained<br>Earnings<br>(post<br>12/17/2009) | Common<br>Equity<br>(pre<br>12/17/2009) | Accumulated<br>Other<br>Comprehensive<br>Income (Loss) | Total      |
|---|-----------------|----------------------------------|--|---|--|------------|
| <b>December 31, 2006</b>  | \$              | \$                               | \$   | \$ 183,918                              | \$ 15,630  | \$ 199,548 |
| Net loss  |                 |                                  |  | (43,749)                                |  | (43,749)   |
| Other comprehensive loss  |                 |                                  |  |   |  |            |
| Foreign currency translation adjustments, net of tax                    |                 |                                  |  |   | 21,457   | 21,457     |
| Realized loss on interest rate swaps, net of tax                        |                 |                                  |  |   | (1,863)  | (1,863)    |
| Decrease in pension liability, net of deferred tax liability of \$1,800 |                 |                                  |  |   | 4,337  | 4,337      |
| Total comprehensive loss  |                 |                                  |  |   |  | (19,818)   |
| Non-cash compensation related to equity awards                          |                 |                                  |  | 2,781                                   |  | 2,781      |
| <b>December 31, 2007</b>  |                 |                                  |  | 142,950                                 | 39,561   | 182,511    |
| Net income  |                 |                                  |  | 28,419                                  |  | 28,419     |
| Other comprehensive loss  |                 |                                  |  |   |  |            |
| Foreign currency translation adjustments, net of tax                    |                 |                                  |  |   | 5,396  | 5,396      |
| Net unrealized loss on interest rate swaps                              |                 |                                  |  |   | (858)  | (858)      |
| Reclassification of interest rate swaps into earnings                   |                 |                                  |  |   | (1,326)  | (1,326)    |
| Increase in pension liability, net of tax                               |                 |                                  |  |   | (36,950)   | (36,950)   |
| Total comprehensive loss  |                 |                                  |  |   |  | (5,319)    |
| Cash contribution from member   |                 |                                  |  | 10,000                                  |  | 10,000     |
| Non-cash compensation related to equity awards                          |                 |                                  |  | 1,184                                   |  | 1,184      |
| <b>December 31, 2008</b>  |                 |                                  |  | 182,553                                 | 5,823  | 188,376    |
| Net loss  |                 |                                  | (14)   | (276)                                   |  | (290)      |
| Other comprehensive income  |                 |                                  |  |   |  |            |
| Foreign currency translation adjustments, net of tax                    |                 |                                  |  |   | 14,023   | 14,023     |
| Net unrealized loss on interest rate swaps                              |                 |                                  |  |   | 3,158  | 3,158      |
| Reclassification of interest rate swaps into earnings                   |                 |                                  |  |   | (2,827)  | (2,827)    |
| Increase in pension liability, net of tax                               |                 |                                  |  |   | 16,659   | 16,659     |
| Total comprehensive income  |                 |                                  |  |   |  | 30,723     |
| Non-cash compensation related to equity awards                          |                 |                                  |  | 2,160                                   |  | 2,160      |
| Liquidation of Kraton Polymers Management LLC                           |                 |                                  |  | (1,760)                                 |  | (1,760)    |
| Non-cash contribution from member                                       |                 |                                  |  | 2,560                                   |  | 2,560      |
| Equity conversion December 16, 2009                                     | 194             | 185,043                          |  | (185,237)                               |  |            |
| Public stock offering, December 17, 2009                                | 103             | 126,622                          |  |   |  | 126,725    |
| <b>December 31, 2009</b>  | \$ 297          | \$ 311,665                       | \$ (14)                                      |   | \$ 36,836  | \$ 348,784 |

See Notes to Consolidated Financial Statements





Index to Financial Statements

## KRATON PERFORMANCE POLYMERS, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

|  | Years ended December 31, |                   |                  |
|--|--------------------------|-------------------|------------------|
|  | 2009                     | 2008              | 2007             |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>  |                          |                   |                  |
| Net income (loss)  | \$ (290)                 | \$ 28,419         | \$ (43,749)      |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: |                          |                   |                  |
| Depreciation and amortization of identifiable intangibles                                | 66,751                   | 53,162            | 51,917           |
| Accretion of debt discount   | 5                        | 24                | 24               |
| Inventory impairment   | 1,769                    | 8,100             |                  |
| Amortization of deferred financing costs   | 4,090                    | 2,139             | 2,715            |
| Loss on disposal of fixed assets   | 348                      | 184               | 274              |
| Gain on extinguishment of debt   | (23,831)                 |                   |                  |
| Change in fair value of interest rate swaps  | (2,827)                  | (1,378)           | (1,553)          |
| Distributed (undistributed) earnings in unconsolidated joint venture                     | 30                       | 604               | (520)            |
| Deferred income tax expense (benefit)  | (4,623)                  | (5,445)           | 1,519            |
| Non-cash compensation related to equity awards   | 2,160                    | 1,184             | 2,781            |
| Decrease (increase) in   |                          |                   |                  |
| Accounts receivable  | (16,680)                 | 42,815            | 8,710            |
| Due to/from related party  | (6,180)                  | (6,007)           | 14,704           |
| Inventories of products, materials and supplies  | 44,060                   | (86,738)          | 17,793           |
| Other assets   | (305)                    | (1,377)           | (1,525)          |
| Increase in  |                          |                   |                  |
| Accounts payable-trade, other payables and accruals, and long-term                       | 8,328                    | 4,541             | 28,647           |
| Net cash provided by operating activities  | 72,805                   | 40,227            | 81,737           |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>  |                          |                   |                  |
| Purchase of property, plant and equipment  | (38,101)                 | (24,093)          | (28,713)         |
| Purchase of software   | (15,322)                 |                   |                  |
| Proceeds from sale of property, plant and equipment                                      | 3,870                    | 26                | 43               |
| Net cash used in investing activities  | (49,553)                 | (24,067)          | (28,670)         |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES</b>  |                          |                   |                  |
| Proceeds from debt   | 144,000                  | 316,250           | 48,500           |
| Repayment of debt  | (308,131)                | (279,644)         | (92,148)         |
| Cash contribution from member  |                          | 10,000            |                  |
| Proceeds from issuance of common stock   | 126,725                  |                   |                  |
| Repayment of insurance note payable  |                          | (494)             | (245)            |
| Deferred financing costs   | (3,216)                  |                   |                  |
| Net cash provided by (used in) financing activities                                      | (40,622)                 | 46,112            | (43,893)         |
| Effect of exchange rate differences on cash  | (14,735)                 | (9,153)           | (4,498)          |
| Net increase (decrease) in cash and cash equivalents                                     | (32,105)                 | 53,119            | 4,676            |
| <b>Cash and cash equivalents at beginning of period</b>                                  | <b>101,396</b>           | <b>48,277</b>     | <b>43,601</b>    |
| <b>Cash and cash equivalents at end of period</b>  | <b>\$ 69,291</b>         | <b>\$ 101,396</b> | <b>\$ 48,277</b> |

**Supplemental Disclosures**

|  |           |           |           |
|--|-----------|-----------|-----------|
| Cash paid during the period for income taxes | \$ 9,164  | \$ 11,251 | \$ 8,912  |
| Cash paid during the period for interest     | \$ 34,707 | \$ 39,533 | \$ 37,052 |

See Notes to Consolidated Financial Statements

F-6

**Index to Financial Statements****KRATON PERFORMANCE POLYMERS, INC.****Notes to Consolidated Financial Statements****INDEX**

|  | <b>PAGE</b> |
|--|-------------|
| <u>1. Summary of Operations and Significant Accounting Policies</u>  | F-7         |
| <u>2. Share-Based Compensation</u>                                   | F-14        |
| <u>3. Detail of Certain Balance Sheet Accounts</u>                   | F-17        |
| <u>4. Long-Term Debt</u>   | F-18        |
| <u>5. Deferred Financing Costs</u>                                   | F-23        |
| <u>6. Income Taxes</u>   | F-23        |
| <u>7. Employee Benefits</u>  | F-27        |
| <u>8. Commitments and Contingencies</u>                              | F-37        |
| <u>9. Fair Value Measurements</u>                                    | F-39        |
| <u>10. Significant Contracts</u>                                     | F-39        |
| <u>11. Related Party Transactions</u>                                | F-41        |
| <u>12. Earnings per Common Share</u>                                 | F-42        |
| <u>13. Industry Segment and Foreign Operations</u>                   | F-43        |
| <u>14. Supplemental Guarantor Information</u>                        | F-44        |
| <u>15. Financial Instruments, Hedging Activities and Credit Risk</u> | F-53        |
| <u>16. Restructuring and Restructuring-related Costs</u>             | F-55        |
| <u>17. Subsequent Event</u>  | F-55        |
| <b>1. Summary of Operations and Significant Accounting Policies</b>  |             |

**Organization and Description of Business.** Kraton Performance Polymers, Inc., or Kraton Performance Polymers, and its direct and indirect subsidiaries, are, unless the context requires otherwise, collectively referred to herein as we, our, us, our company and/or the Company. Kraton Performance Polymers is the sole Member and 100% equity owner of Kraton Polymers LLC. As used herein, the term Kraton refers to Kraton Polymers LLC, and, unless the context herein requires otherwise, said term shall include the direct and indirect subsidiaries of Kraton Polymers LLC. Kraton Polymers LLC directly or indirectly owns 100% of the equity interests in (1) Elastomers Holdings LLC (holding company of Kraton's United States (U.S.) operations), (2) K.P. Global Holdings C.V. (holding company of the remainder of our global operations) and (3) Kraton Polymers Capital Corporation (a company with no obligations). We believe we are the world's leading producer in terms of sales revenues and sales volumes of styrenic block copolymers, or SBCs, a family of performance polymer products whose chemistry we pioneered over 40 years ago. SBCs are highly-engineered synthetic elastomers which enhance the performance of numerous products by delivering a variety of performance-enhancing characteristics, including greater flexibility, resilience, strength, durability and processability, and are a fast growing subset of the elastomers industry. Our polymers are typically formulated or compounded with other products to achieve improved, customer specific performance characteristics in a variety of applications. We manufacture products at five plants globally, including our flagship plant in Belpre, Ohio, the largest and most diversified SBC plant in the world, as well as plants in Germany, France, Brazil, and Japan. The plant in Japan is operated by a unconsolidated manufacturing joint venture.

**Corporate History**

Prior to February 28, 2001, we operated as a number of business units as a part of Shell Chemicals and did not exist as a stand-alone entity. On February 28, 2001, Ripplewood Chemical Holding LLC, or Ripplewood Chemical, acquired us from Shell Chemicals through a master sale agreement. On December 23, 2003, Polymer Holdings LLC acquired all of Kraton's outstanding equity interests from Ripplewood Chemical. Prior to our initial public offering and related reorganization transactions, described below, we were a wholly-owned

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**Index to Financial Statements**

**KRATON PERFORMANCE POLYMERS, INC.**

**Notes to Consolidated Financial Statements (Continued)**

subsidiary of TJ Chemical Holdings LLC and were indirectly owned by certain affiliates of TPG Capital, L.P., which we refer to collectively as TPG, and certain affiliates of J.P. Morgan Partners, LLC, which we refer to collectively as JPMP, and certain members of our management.

**Initial Public Offering**

On December 16, 2009, Polymer Holdings, and its consolidated subsidiaries were converted from a Delaware limited liability company to a Delaware corporation and renamed Kraton Performance Polymers, Inc. In addition, prior to the closing of the IPO, TJ Chemical, was merged into (and did not survive the merger with) Kraton. Trading in shares of our common stock on the NYSE commenced on December 17, 2009 under the symbol KRA. On December 22, 2009, Kraton Performance Polymers, Inc., the parent and owner of 100% of the membership interests in Kraton closed its IPO. Including 887,082 shares issued on January 7, 2010 following the exercise of the underwriters' over-allotment option, the aggregate shares issued in connection with the IPO amounted to 11,181,200 shares, at a price of \$13.50 per share, and the net proceeds after the underwriting discounts and commissions and fees and expenses amounted to approximately \$138.0 million. We used \$100.0 million of the net proceeds to prepay outstanding indebtedness, with the balance to be used for general corporate purposes, including to fund strategic capital projects such as alternative production capabilities for Isoprene Rubber or IR, the development of additional capacity in our Isoprene Latex business, and/or the continuation of our upgrade of certain systems and operating controls at our Belpre, Ohio facility. Following the IPO, related reorganization transactions, and the exercise of the underwriters' over-allotment option TPG, owned approximately 37.6% of our common stock and JPMP, owned approximately 25.1% of our common stock.

**Basis of Presentation.** The accompanying Consolidated Financial Statements presented herein are for us and our consolidated subsidiaries, each of which is a wholly-owned subsidiary. Polymer Holdings LLC, or Polymer Holdings, and its consolidated subsidiaries are treated as our predecessor entity for financial statement reporting purposes. The Consolidated Financial Statements present our historical financial statements and the historical financial statements of our predecessor. Accordingly the information for periods prior to December 22, 2009, is that of Polymer Holdings. The historical Consolidated Financial Statements presented for the years ended December 31, 2009, 2008 and 2007 and as of December 31, 2009 and 2008 have been derived from our audited consolidated financial statements.

These financial statements reflect all normal recurring adjustments that are, in the opinion of management, necessary to fairly present our results of operations and financial position.

**Use of Estimates.** The preparation of 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 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, income tax uncertainties and other contingencies.

**Reclassifications.** Certain amounts reported in the Consolidated Financial Statements and Notes to Consolidated Financial Statements for the prior periods have been reclassified to conform to the current reporting presentation.

**Cash and Cash Equivalents.** It is our policy to invest our excess cash in investment instruments whose value is not subject to market fluctuations, such as bank deposits or certificates of deposit. Other permitted

Index to Financial Statements

**KRATON PERFORMANCE POLYMERS, INC.**

**Notes to Consolidated Financial Statements (Continued)**

investments include commercial paper of major U.S. corporations with ratings of A1 by Standard & Poor's Ratings Group or P1 by Moody's Investor Services, Inc., loan participations of major U.S. corporations with a short term credit rating of A1/P1 and direct obligations of the U.S. government or its agencies. We consider all investments having a remaining maturity of 3 months or less to be cash equivalents.

**Receivables.** Receivables are recorded at the invoiced amount and do not bear interest. The allowance for doubtful accounts is our best estimate of the amount of probable credit losses in our existing receivables. We determine the allowance based on historical write-off experience and global economic data. We review the allowance for doubtful accounts quarterly. Past due balances over 90 days and above a specified amount are reviewed individually for collectibility. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. We do not have any off-balance sheet credit exposure related to our customers.

**Inventories.** Our inventory is principally comprised of finished goods inventory. Inventories are stated at the lower of cost or market as determined on a first-in, first-out basis. On a quarterly basis, we evaluate the carrying cost of our inventory to ensure that it is stated at the lower of cost or market. Our products are typically not subject to spoiling or obsolescence and consequently our reserves for slow moving and obsolete inventory have historically not been significant. Cash flows from the sale of inventory are reported in cash flows from operations in the consolidated statement of cash flows.

**Derivative Instruments and Hedging Activities.** We account for derivatives and hedging activities in accordance with FASB ASC Topic 815, *Derivatives and Hedging* (Statement No. 133, *Accounting for Derivative Instruments and Certain Hedging Activities*, as amended), which requires entities to recognize all derivative instruments as either assets or liabilities in the balance sheet at their respective fair values. For derivatives designated in cash flow hedging relationships, changes in the fair value are either offset through earnings against the change in fair value of the hedged item attributable to the risk being hedged or recognized in accumulated other comprehensive income, to the extent the derivative is effective at offsetting the changes in cash flows being hedged until the hedged item affects earnings.

For all hedging relationships, we formally document the hedging relationship and our risk-management objective and strategy for undertaking the hedge, the hedging instrument, the hedged transaction, the nature of the risk being hedged, how the hedging instrument's effectiveness in offsetting the hedged risk will be assessed prospectively and retrospectively, and a description of the method used to measure ineffectiveness. We also formally assesses, both at the inception of the hedging relationship and on an ongoing basis, whether the derivatives that are used in hedging relationships are highly effective in offsetting changes in cash flows of hedged transactions. For derivative instruments that are designated and qualify as part of a cash flow hedging relationship, the effective portion of the gain or loss on the derivative is reported as a component of other comprehensive income and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Gains and losses on the derivative representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current earnings.

We discontinue hedge accounting prospectively when we determine that the derivative is no longer effective in offsetting cash flows attributable to the hedged risk, the derivative expires or is sold, terminated, or exercised, the cash flow hedge is dedesignated because a forecasted transaction is not probable of occurring, or management determines to remove the designation of the cash flow hedge.

In all situations in which hedge accounting is discontinued and the derivative remains outstanding, we continue to carry the derivative at its fair value on the balance sheet and recognize any subsequent changes in its

Index to Financial Statements**KRATON PERFORMANCE POLYMERS, INC.****Notes to Consolidated Financial Statements (Continued)**

fair value in earnings. When it is probable that a forecasted transaction will not occur, we discontinue hedge accounting and recognize immediately in earnings gains and losses that were accumulated in other comprehensive income related to the hedging relationship.

**Property, Plant and Equipment.** Property, plant and equipment are recorded at cost. Major renewals and improvements which extend the useful lives of equipment are capitalized. Repair and maintenance expenses are charged to operations as incurred. Disposals are removed at carrying cost less accumulated depreciation with any resulting gain or loss reflected in operations. We capitalize interest costs which are incurred as part of the cost of constructing major facilities and equipment. We did not record any capitalized interest in any periods presented. Depreciation is provided using the straight-line method over the following average estimated useful lives:

|                                       |          |
|---------------------------------------|----------|
| Machinery and equipment               | 20 years |
| Building and land improvements        | 20 years |
| Computer hardware/information systems | 3 years  |
| Office equipment                      | 5 years  |
| Research equipment and facilities     | 5 years  |
| Vehicles                              | 5 years  |

**Major Maintenance Activities.** We incur maintenance costs on our major equipment. Repair and maintenance costs are expensed as incurred.

**Asset Retirement Obligations.** We account for asset retirement obligations pursuant to the provisions of ASC 410-20, Asset Retirement Obligations. ASC 410-20 requires us to record the fair value of an asset retirement obligation as a liability in the period in which we incur a legal obligation associated with the retirement of tangible long-lived assets that result from the acquisition, construction, development, and/or normal use of the assets. ASC 410-20 also requires us to record a corresponding asset that is depreciated over the life of the asset. Subsequent to the initial measurement of the asset retirement obligation, the obligation is to be adjusted at the end of each period to reflect the passage of time and changes in the estimated future cash flows underlying the obligation.

We have no assets that are legally restricted for purposes of settling asset retirement obligations. We have determined that we have contractual or regulatory requirements to decommission and perform other remediation for many of our manufacturing facilities and other assets upon retirement. These manufacturing facilities have historically been profitable, and we plan to continue to upgrade these assets and expand the manufacturing capacity in conjunction with the growing market for our products. We plan to operate our manufacturing facilities for the foreseeable future and there are no current plans to close or convert these assets for use in the manufacture of fundamentally different products. Unlike our manufacturing assets in the United States and Brazil, our manufacturing assets in Europe are all located on leased land. For these assets, we used the lease termination dates as the estimate for when our asset retirement obligations related to those assets will be settled.

**Long-Lived Assets.** In accordance with Impairment or Disposal of Long-Lived Assets Subsections of FASB ASC Subtopic 360-10, *Property, Plant, and Equipment Overall*, (FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, long-lived assets, such as property, plant, and equipment, and purchased intangible assets subject to amortization, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If circumstances require a long-lived asset or asset group be tested for possible impairment, we first compare undiscounted cash flows expected to be generated by that asset or asset group to its carrying value. If the carrying value of the long-lived asset or asset group is not recoverable on an undiscounted cash flow basis, an impairment is recognized to the

**Index to Financial Statements**

**KRATON PERFORMANCE POLYMERS, INC.**

**Notes to Consolidated Financial Statements (Continued)**

extent that the carrying value exceeds its fair value. Fair value is determined through various valuation techniques including discounted cash flow models, quoted market values and third-party independent appraisals, as considered necessary.

**Identifiable Intangible Assets.** We have identifiable intangible assets related to technology, tradenames/trademarks, customer relationships and software as detailed in Note 3 below. Identifiable intangible assets are amortized on the straight-line method over the estimated useful lives of the assets. The estimated useful life of technology, tradenames/trademarks and customer relationships is 15 years, while the estimated useful life of software is 10 years.

**Pension and Other Postretirement Plans.** We have a noncontributory defined benefit pension plan covering substantially all of our employees upon their retirement. The benefits are based on age, years of service and the level of compensation during the five years before retirement. We also sponsor a defined benefit health care plan for substantially all retirees and full-time employees.

We record annual amounts relating to our pension and postretirement plans based on calculations that incorporate various actuarial and other assumptions, including discount rates, mortality, assumed rates of return, compensation increases, turnover rates and healthcare cost trend rates. We review our assumptions on an annual basis and make modifications to the assumptions based on current rates and trends when it is appropriate to do so. The effect of modifications to those assumptions is recorded in accumulated other comprehensive income and amortized to net periodic cost over future periods using the corridor method. We believe that the assumptions utilized in recording our obligations under our plans are reasonable based on our experience and market conditions.

The net periodic costs are recognized as employees render the services necessary to earn the postretirement benefits.

**Investment in Unconsolidated Joint Venture.** Our 50% equity investment in a manufacturing joint venture at our Kashima site is accounted for under the equity method with our share of the operating results of the joint venture classified within equity in earnings of unconsolidated joint venture in the Consolidated Statements of Operations.

We evaluate our equity method investment for impairment when events or changes in circumstances indicate, in management's judgment, that the carrying value of such investment may have experienced an other-than-temporary decline in value. When evidence of loss in value has occurred, management compares the estimated fair value of the investment to the carrying value of the investment to determine whether an impairment has occurred. Management assesses the fair value of its equity method investment using commonly accepted techniques, and may use more than one method, including, but not limited to, recent third party comparable sales, internally developed discounted cash flow analysis and analysis from outside advisors. If the estimated fair value is less than the carrying value and management considers the decline in value to be other than temporary, the excess of the carrying value over the estimated fair value is recognized in the financial statements as an impairment.

**Deferred Financing Costs.** We capitalize financing fees and other related costs and amortize them to interest expense over the term of the related debt instrument using the effective interest method.

**Environmental Costs.** Environmental costs are expensed as incurred unless the expenditures extend the economic useful life of the relevant assets. Costs that extend the economic life of assets are capitalized and

depreciated over the remaining life of those assets. Liabilities are recorded when environmental assessments, or remedial efforts are probable, and the cost can be reasonably estimated.

**Index to Financial Statements**

**KRATON PERFORMANCE POLYMERS, INC.**

**Notes to Consolidated Financial Statements (Continued)**

**Disclosures about Fair Value of Financial Instruments.** The carrying amount approximates fair value for cash and cash equivalents, receivables, accounts payable and certain accrued expenses due to the short maturities of these instruments. The fair values of long-term debt instruments and the interest rate swap agreements are estimated based upon market values (if applicable) or on the current interest rates available to us for debt with similar terms and remaining maturities. Considerable judgment is required in developing these estimates.

**Revenue Recognition.** Sales are recognized in accordance with the U.S. Securities and Exchange Commission's Staff Accounting Bulletin (SAB) No. 104, Revenue Recognition in Financial Statements when the revenue is realized or realizable, and has been earned. Revenue for product sales is recognized as risk and title to the product transfer to the customer, which usually occurs at the time shipment is made. The Company's products are generally sold FOB (free on board) shipping point or, with respect to countries other than the United States, an equivalent basis. As such, title to the product passes when the product is delivered to the freight carrier. The Company's standard terms of delivery are included in its contracts of sale, order confirmation documents and invoices.

Shipping and other transportation costs charged to customers are recorded in both sales and cost of sales. Sales revenues are reduced by the expense of rebates to customers as agreed upon volume targets are met.

We have entered into agreements with some of our customers, whereby they earn rebates from us when the volume of their purchases of our product reach certain agreed upon levels. We recognize the rebate obligation under these agreements as a reduction of revenue based on an allocation of the cost of honoring the rebates that are earned to each of the underlying revenue transactions that result in progress by the customer toward earning the rebate.

**Research and Development Expenses.** Research and development expenses are expensed as incurred.

**Leases.** All leases entered into as of December 31, 2009 are classified as operating leases. For those leases which contain escalating rent payment clauses, we use the straight-line method to record lease expense.

**Income Taxes.** We conduct operations in separate legal entities; as a result, income tax amounts are reflected in these consolidated financial statements for each of those jurisdictions.

Deferred taxes result from differences between the financial and tax bases of our assets and liabilities and are adjusted for changes in tax rates and tax laws when changes are enacted. Valuation allowances are recorded to reduce deferred tax assets when it is more likely than not that a tax benefit will not be realized.

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

**Foreign Currency Translation and Foreign Currency Exchange Rates.** Financial statements of our operations outside the United States where the local currency is considered to be the functional currency are translated into U.S. dollars using the exchange rate at each balance sheet date for assets and liabilities and the



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**Index to Financial Statements**

**KRATON PERFORMANCE POLYMERS, INC.**

**Notes to Consolidated Financial Statements (Continued)**

average exchange rate for each period for revenues, expenses, gains, and losses and cash flows. The effects of translating such operations into U.S. dollars are included as a component of other comprehensive income (loss) in stockholders' / member's equity.

**New Accounting Pronouncements 2009.** The following new accounting pronouncements were adopted during 2009 and the effect of such adoption, if applicable, has been presented in the accompanying Consolidated Financial Statements:

***Adopted Accounting Standards***

In January 2009, the Financial Accounting Standards Board ( FASB ), issued *FASB Staff Position ( FSP ) No. FAS No. 132(R)-1 Employers Disclosures about Pensions and Other Postretirement Benefit Plan Assets ( FSP FAS No. 132(R)-1 )*, included in the Codification as ASC 715-20-65-2. This topic provides guidance on an employer's disclosures about plan assets of a defined benefit pension or other postretirement plan. This topic is effective for fiscal years ending after December 15, 2009. Our adoption of the new guidance did not have a material effect on our consolidated financial statements.

In May 2009, the FASB issued new guidance for subsequent events. The new guidance, which is part of ASC 855, *Subsequent Events*, is intended to establish general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. Specifically, this guidance sets forth the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements, and the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. The new guidance is effective for fiscal years and interim periods ended after June 15, 2009 and will be applied prospectively. Our adoption of the new guidance did not have a material effect on our consolidated financial statements.

In April 2008, the FASB issued *FSP No. 142-3, Determination of the Useful Life of Intangible Assets ( FSP No. 142-3 )*, included in the Codification as ASC 350-30-50-4. This topic amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset. This topic is effective for financial statements issued for fiscal years beginning after December 15, 2008 and interim periods within those fiscal years. On January 1, 2009, we adopted this topic, which did not have any impact on our consolidated financial statements.

In March 2008, the FASB issued *SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities-an amendment of FASB Statement No. 133 ( SFAS No. 161 )*, included in the Codification as ASC 815-10-65-1. This topic requires enhanced disclosure related to derivatives and hedging activities. This topic must be applied prospectively to all derivative instruments and non-derivative instruments that are designated and qualify as hedging instruments and related hedged items for all financial statements issued for fiscal years and interim periods beginning after November 15, 2008. We adopted this topic on January 1, 2009.

In December 2007, the FASB issued *SFAS No. 141 (revised 2007), Business Combinations ( SFAS 141(R) )*, which is a revision of SFAS 141, *Business Combinations*, included in the Codification as ASC 805-10-05-2. The primary requirements of this topic are as follows: (i) Upon initially obtaining control, the acquiring entity in a business combination must recognize 100% of the fair values of the acquired assets, including goodwill, and assumed liabilities, with only limited exceptions even if the acquirer has not acquired 100% of its target. As a consequence, the current step acquisition model will be eliminated. (ii) Contingent

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**Index to Financial Statements**

**KRATON PERFORMANCE POLYMERS, INC.**

**Notes to Consolidated Financial Statements (Continued)**

consideration arrangements will be fair valued at the acquisition date and included on that basis in the purchase price consideration. The concept of recognizing contingent consideration at a later date when the amount of that consideration is determinable beyond a reasonable doubt, will no longer be applicable. (iii) All transaction costs will be expensed as incurred. This topic is effective as of the beginning of an entity's first fiscal year beginning after December 15, 2008. Our adoption of this topic on January 1, 2009 has had no impact to our financial position, results of operations or cash flows. A significant impact may, however, be realized on any future acquisitions by us. The amount of such impact will depend on the nature and terms of such future acquisition, if any.

**New Accounting Pronouncements.** The following new accounting pronouncements have been issued, but have not yet been adopted as of December 31, 2009:

***Future Adoption of Accounting Standards***

In October 2009, FASB issued Accounting Standards Update (ASU), Number 2009-13 Revenue Recognition (Topic 605): Multiple-Deliverable Arrangements consensus of the FASB Emerging Issues Task Force. This update amends the revenue recognition guidance for arrangements with multiple deliverables. The amendments allow vendors to account for products and services separately rather than as a combined unit. A selling price hierarchy for determining the selling price of each deliverable is established in this ASU, along with eliminating the residual method. The amendments are effective for revenue arrangements that begin or are changed in fiscal years that start June 15, 2010 or later. We are in the process of assessing the provisions of this new guidance and currently do not expect that the adoption will have a material impact on our consolidated financial statements.

**2. Share-Based Compensation**

We account for share-based awards under the provisions of ASC 718, Share-Based Payment, 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 is recognized as expense over the requisite service period. We record non-cash compensation expense for the restricted membership units, notional membership units and option awards over the vesting period using the straight-line method. See Note 12 for further discussion.

See Note 7(f) for a description of the TJ Chemical Holdings LLC 2004 Option Plan. There were 0, 11,463, 118 and 50,000 options granted under this plan to our employees and directors during the years ended December 31, 2009, 2008 and 2007, respectively. We awarded 74,008 shares of restricted stock on December 22, 2009. There were no options exercised during the years ended December 31, 2009, 2008 and 2007, respectively.

We record non-cash compensation expense for the restricted membership units, notional membership units and option awards over the vesting period using the straight-line method. We recorded share-based employee compensation expense of approximately \$1.4 million, \$0.8 million and \$1.5 million for the years ended December 31, 2009, 2008 and 2007, respectively, net of tax effects of \$0.8 million, \$0.4 million and \$0.9 million, respectively. At December 31, 2009, there was approximately \$1.4 million of unrecognized compensation cost related to non-vested option awards, and \$1.5 million of unrecognized compensation expense related to non-vested restricted membership unit and notional membership unit awards expected to be recognized over a weighted-average period of 6.8 years.

**Index to Financial Statements****KRATON PERFORMANCE POLYMERS, INC.****Notes to Consolidated Financial Statements (Continued)*****Stock Option Activity***

Information pertaining to option activity for the year ended December 31, 2009 is as follows:

|   | Options<br>(in thousands) | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Remaining<br>Life<br>(in years) | Aggregate<br>Intrinsic<br>Value(1)<br>(in millions) |
|---|---------------------------|--|--|---|
| Outstanding at December 31, 2008            | 22,101                    | \$ 1.00                                  | 6.8  |   |
| Granted                                     |                           |  |  |   |
| Exercised                                   |                           |  |  |   |
| Forfeited or expired                        | 685                       | 1.00                                     |  |   |
| Outstanding at December 16, 2009            | 21,416                    | 1.00                                     |  |   |
| Conversion rate is 7.4008 new to 100 old(2) |                           |  |  |   |
| Outstanding at December 17, 2009            | 1,585                     | 13.51                                    |  |   |
| Granted                                     |                           |  |  |   |
| Exercised                                   |                           |  |  |   |
| Forfeited or expired                        |                           |  |  |   |
| Outstanding at December 31, 2009            | 1,585                     | 13.51                                    | 6.8  | 0.1   |
| Exercisable at December 31, 2009            | 955                       | 13.51                                    | 6.0  |   |

(1) The intrinsic value of a stock option is the amount by which the market value of the underlying stock exceeds the exercise price of the option.

(2)  $100 \div 7.4008 = 13.51$ .

Prior to December 17, 2009, we engaged an independent valuation and financial consultant to estimate the fair value of the options issued using the Black-Scholes Merton option-pricing model.

The number, weighted average exercise price and weighted average remaining contractual life of options outstanding as of December 31, 2009, and the number and weighted average exercise price of options exercisable as of December 31, 2009 follow:

|                     | Range of<br>Exercise Prices | Options<br>(in thousands) | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Remaining<br>Life<br>(in years) |
|---------------------|-----------------------------|---------------------------|--|--|
| Outstanding options | \$ 13.51                    | 1,585                     | \$ 13.51                                 | 6.8  |
| Exercisable options | 13.51                       | 955                       | 13.51                                    | 6.0  |

## Edgar Filing: Kraton Performance Polymers, Inc. - Form 10-K/A

See Note 7(e) for a description of the TJ Chemical Holdings LLC Membership Units Plan. TJ Chemical Holdings LLC may grant time-vested restricted membership units and time-vested notional membership units to certain employees. Holders of notional membership units do not have any beneficial ownership in the underlying membership units and the grant represents an unsecured promise to deliver membership units on a future date. Actual membership units underlying the restricted membership units and the notional membership units will not be distributed until the earlier of a change in control or the termination of the grantee's employment.

F-15

**Index to Financial Statements****KRATON PERFORMANCE POLYMERS, INC.****Notes to Consolidated Financial Statements (Continued)**

The following table represents the restricted membership units, notional membership units and restricted stock granted, vested and forfeited during 2009.

|  | Unit<br>(in thousands) | Grant Date<br>Fair Value<br>per Unit |
|--|------------------------|--------------------------------------|
| <b><i>Restricted and Notional Units and Restricted Stock</i></b> |                        |                                      |
| Non-vested shares at January 1, 2009                             | 2,454                  | \$ 1.00                              |
| Granted  |                        |                                      |
| Vested   |                        |                                      |
| Forfeited  | 729                    | 1.00                                 |
| Non-vested shares at December 16, 2009                           | 1,725                  | \$ 1.00                              |
| Conversion rate is 7.4008 new to 100 old                         |                        |                                      |
| Non-vested shares at December 17, 2009                           | 128                    | \$ 13.51                             |
| Granted  | 74                     | 13.51                                |
| Vested   |                        |                                      |
| Forfeited  |                        |                                      |
| Non-vested shares at December 31, 2009                           | 202                    | \$ 13.51                             |

***Weighted-Average Assumptions for Option Pricing***

|                         | 2009 | 2008    | 2007    |
|-------------------------|------|---------|---------|
| Risk-free interest rate | n/a  | 3.59%   | 3.40%   |
| Expected dividend yield | n/a  | 0.00%   | 0.00%   |
| Expected volatility     | n/a  | 0.38    | 0.40    |
| Expected term           | n/a  | 5 years | 5 years |

Since our membership units were privately held prior to the IPO, the estimated volatility is based on the historical volatility of similar companies stock that is publicly traded. The expected term of options represents the period of time that options granted are expected to be outstanding. The risk free interest rate for the periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

The weighted average fair value per option at the date of grant for options granted in 2008 and 2007 was \$0.31 in both years, as valued using the Black-Scholes Merton option-pricing model. No options were granted in 2009. Option grants subsequent to 2009 will be valued at the fair market value of our common stock on the date of grant.

**Index to Financial Statements****KRATON PERFORMANCE POLYMERS, INC.****Notes to Consolidated Financial Statements (Continued)****3. Detail of Certain Balance Sheet Accounts**

|                                 | <b>December 31,</b>   |             |
|---------------------------------|-----------------------|-------------|
|                                 | <b>2009</b>           | <b>2008</b> |
|                                 | <b>(in thousands)</b> |             |
| Inventories of products, net:   |                       |             |
| Finished products               | \$ 223,500            | \$ 271,449  |
| Work in progress                | 3,254                 | 1,781       |
| Raw materials                   | 57,504                | 50,963      |
|                                 | \$ 284,258            | \$ 324,193  |
| Property, plant and equipment:  |                       |             |
| Land                            | \$ 8,782              | \$ 15,240   |
| Buildings                       | 32,467                | 37,601      |
| Plant and equipment             | 508,057               | 482,880     |
| Construction in progress        | 42,112                | 18,539      |
|                                 | 591,418               | 554,260     |
| Less accumulated depreciation   | 236,558               | 182,252     |
|                                 | \$ 354,860            | \$ 372,008  |
| Identifiable intangible assets: |                       |             |
| Technology                      | \$ 44,813             | \$ 44,813   |
| Customer relations              | 35,213                | 35,213      |
| Trademarks                      | 23,194                | 23,194      |
| Software                        | 15,322                |             |
|                                 | 118,542               | 103,220     |
| Less accumulated amortization   | 42,741                | 36,169      |
|                                 | \$ 75,801             | \$ 67,051   |
| Other payables and accruals:    |                       |             |
| Employee related                | \$ 5,783              | \$ 25,418   |
| Interest                        | 7,366                 | 10,316      |
| Property and other taxes        | 4,255                 |             |
| Customer rebates                | 2,960                 | 4,402       |
| Income taxes payable            | 4,000                 | 8,538       |
| Derivative liabilities          | 2,926                 | 5,483       |
| Pernis restructuring            | 9,874                 |             |
| Other                           | 31,107                | 15,192      |
|                                 | \$ 68,271             | \$ 69,349   |

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We recorded lower-of-cost-or-market adjustments for inventories in cost of goods sold of \$0.7 million and \$8.1 million in 2009 and 2008, respectively.

The identifiable intangible assets are amortized on the straight-line method over the estimated useful lives of the assets. The estimated useful life of technology, tradenames/trademarks and customer relationships is 15 years, while the estimated useful life of software is 10 years. Aggregate amortization expense for amortizing intangible assets was approximately \$6.6 million, \$7.0 million and \$7.2 million for the years ended December 31, 2009, 2008 and 2007, respectively. Estimated amortization expense for each of the next five years

F-17

Index to Financial Statements**KRATON PERFORMANCE POLYMERS, INC.****Notes to Consolidated Financial Statements (Continued)**

is approximately \$6.6 million. Identifiable intangibles were adjusted in 2007 for the realization of certain excess tax basis that had not previously been recognized in the consolidated financial statements.

Accumulated other comprehensive income consists of the following:

|  | December 31,<br>2009 | December 31,<br>2008 |
|--|----------------------|----------------------|
|  | (in thousands)       |                      |
| Foreign currency adjustments                       | \$ 55,765            | \$ 41,742            |
| Unrealized gain on interest rate swaps, net of tax | (1,780)              | (2,111)              |
| Pension adjustment, net of tax                     | (17,149)             | (33,808)             |
| Total accumulated other comprehensive income       | \$ 36,836            | \$ 5,823             |

**4. Long-Term Debt**

Long-term debt consists of the following:

|  | December 31,<br>2009 | December 31,<br>2008 |
|--|----------------------|----------------------|
|  | (in thousands)       |                      |
| <b>Senior Secured Credit Facilities:</b> |                      |                      |
| Revolving loans                          | \$                   | \$ 50,000            |
| Term loans                               | 221,729              | 325,071              |
| 12.00% discount notes                    | 250                  | 245                  |
| 8.125% discount notes                    | 170,000              | 200,000              |
| 8.125% discount notes held in Treasury   | (7,000)              |                      |
| Total debt                               | 384,979              | 575,316              |
| Less current portion of long-term debt   | 2,304                | 3,343                |
| Total long-term debt                     | \$ 382,675           | \$ 571,973           |

*(a) Term Loans and Revolving Loans.* On May 12, 2006 we entered into an amendment (the Amendment) to our senior secured credit agreement, or the Credit Agreement, dated as of December 23, 2003, as amended as of March 4, 2004, as further amended as of October 21, 2004 and as further amended as of February 16, 2006 in order to provide a portion of the funds required in connection with the cash tender offer and consent solicitation commenced on April 24, 2006 by us and Polymer Holdings Capital Corporation with respect to any and all of our outstanding 12.0% discount notes. On May 12, 2006 all but \$250,000 of the \$150,000,000 12.0% discount notes validly tendered and not withdrawn in the tender offer (representing approximately 99.8% of the aggregate amount of outstanding 12.0% discount notes) were accepted for payment and purchased for aggregate total consideration equal to \$128,785,000.

The Amendment provided for, among other things, a new term facility (the Term Facility) of \$385 million, representing a \$25 million increase over the original Term Facility, and extending the maturity of the Term Facility from December 23, 2010 to May 12, 2013. The Amendment extended the maturity of the revolving facility (the Revolving Facility), from December 23, 2008 to May 12, 2011 and provided for the possibility of increasing the existing Revolving Facility from \$60 million to \$80 million, subject to new revolving lenders becoming parties to



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the Credit Agreement. On June 7, 2006, we entered into a Joinder Agreement with a new revolving lender that increased the Revolving Facility to \$75.5 million from \$60.0 million. In addition to the foregoing, the Amendment reduced the interest rate margin on the Term Facility, eliminated certain affirmative

F-18

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Index to Financial Statements

**KRATON PERFORMANCE POLYMERS, INC.**

**Notes to Consolidated Financial Statements (Continued)**

and negative covenants, including a covenant that limited our ability to make capital expenditures, and modified the financial ratios we are required to maintain. On the effective date of the Amendment, we borrowed the full \$385 million available under the new Term Facility and used the proceeds to prepay in full existing borrowings under the original Term Facility, provided a portion of the funds necessary to consummate the tender offer for the 12.0% discount notes and pay fees and expenses related to the foregoing.

The amendment as of October 20, 2009, or the October 2009 Amendment, permits Kraton to convert all or a portion of existing term loans into separate classes of extended term loans that extend the scheduled amortization and maturity of the existing term loans. The extended term loans are required to be substantially identical to the terms of the existing term facility, with the exception of scheduled installment payments and maturity, fees, interest rates and prepayment rights. There is no limit on the number of classes of term loans outstanding at any one time. The October 2009 Amendment also permits Kraton to establish separate classes (but in no event more than three at any time) of commitments to replace all or a portion of the existing revolving commitments. The terms of Replacement Revolving Commitments are required to be substantially identical to the terms of the existing revolving commitments, with the exception of maturity, fees and interest rates. Finally, the October 2009 Amendment also allows the Borrower to incur indebtedness secured *pari passu* with the collateral securing the existing lenders under the existing Credit Agreement to refinance existing term loans. This refinancing indebtedness may not amortize or mature prior to the maturity of the existing term loans.

A further amendment on November 30, 2009, or the November 2009 Amendment, increased the maximum available borrowings under the revolving commitments from \$75.5 million to \$80.0 million and extended the maturity on \$79.8 million of the revolving commitments from May 2011 to May 2013.

Kraton is the borrower under the amended Credit Agreement and its wholly-owned domestic subsidiaries along with us have guaranteed the amended Credit Agreement. We refer to these guarantors, together with Kraton, as the Loan Parties. The Credit Agreement is secured by a perfected first priority security interest in substantially all of each Loan Party's tangible and intangible assets, including intellectual property, real property, all of Kraton's capital stock and the capital stock of Kraton's domestic subsidiaries and 65% of the capital stock of the direct foreign subsidiaries of each Loan Party.

For the years ended December 31, 2009, 2008 and 2007, Kraton made prepayments on the term portion of its senior secured credit facility in the amounts of \$100.0 million, \$10.0 million and \$40.0 million, which resulted in the write off of approximately \$1.5 million, \$0.2 million and \$0.6 million of deferred financing cost, respectively.

As of December 31, 2009, Kraton had no outstanding borrowings under the revolving facility.

The following is a summary of the material terms of the amended Credit Agreement. This description does not purport to be complete and is qualified in its entirety by reference to the provisions of the Credit Agreement.

In these notes to the consolidated financial statements, the loans made under the Revolving Facility are referred to as the Revolving Loans, and the loans made under the Term Facility are referred to as the Term Loans.

**Maturity.** The loans made under the portion of the revolving commitments extended pursuant to the November 2009 Amendment are payable in a single maturity on May 12, 2013. The \$200,000 portion of the revolving commitments that were not extended pursuant to November 2009 Amendment are payable on May 12, 2011. The loans made under the existing term facility are payable in 10 remaining consecutive equal quarterly

**Index to Financial Statements**

**KRATON PERFORMANCE POLYMERS, INC.**

**Notes to Consolidated Financial Statements (Continued)**

installments, in an aggregate annual amount equal to 1.0% of the original principal amount of such loans. The remaining balance is payable in four equal quarterly installments commencing on September 30, 2012 and ending on May 12, 2013.

**Interest.** The loans made under the existing term facility bear interest at a rate equal to the adjusted Eurodollar rate plus 2.00% per annum or, at Kraton's option, the base rate plus 1.00% per annum. Interest is payable on the last day of each interest period selected by Kraton under the Credit Agreement, and in any event at least quarterly. The average effective interest rates on the loans made under the existing term facility for the years ended December 31, 2009 and 2008 were 4.5% and 5.0%, respectively. The loans made under the portion of the revolving commitments extended pursuant to the November 2009 Amendment bear interest at a rate equal to the adjusted Eurodollar rate plus a margin of between 3.00% and 3.50% per annum (depending on Kraton's consolidated leverage ratio) or at Kraton's option, the base rate plus a margin of between 2.00% and 2.50% per annum (also depending on Kraton's consolidated leverage ratio). In addition, with respect to the extended portion of the revolving commitments, an annual commitment fee equal to 0.75% payable quarterly on the daily average undrawn portion of revolving commitments extended pursuant to the November 2009 Amendment accrues and is payable quarterly in arrears.

The terms of the \$200,000 portion of the revolving commitments that were not extended pursuant to November 2009 Amendment were not changed. Loans made under this portion of the revolving commitments bear interest at a rate equal to the adjusted Eurodollar rate plus a margin of between 2.00% and 2.50% per annum, depending on Kraton's leverage ratio, or at Kraton's option, the base rate plus a margin of between 1.00% and 1.50% per annum, depending on Kraton's leverage ratio. The unused commitment fee for the unextended revolving commitments is 0.5%.

**Mandatory Prepayments.** The existing term facility is subject to mandatory prepayment with, in general: (1) 100% of the net cash proceeds of certain asset sales, subject to certain reinvestment rights; (2) 100% of the net cash proceeds of certain insurance and condemnation payments, subject to certain reinvestment rights; (3) 50% of the net cash proceeds of certain equity offerings of TJ Chemical Holdings LLC or us (declining to 25%, if a leverage ratio is met); (4) 100% of the net cash proceeds of debt incurrences (other than debt incurrences permitted under the Credit Agreement); and (5) 50% of Kraton's excess cash flow, as defined in the Credit Agreement (declining to 25%, if a leverage ratio is met and to 0% if a further leverage ratio is met). Any such prepayment is applied first to the term facility and thereafter to the revolving facility.

**Covenants.** The Credit Agreement contains certain affirmative covenants including, among others, covenants to furnish the Lenders with financial statements and other financial information and to provide the Lenders notice of material events and information regarding collateral.

The Credit Agreement contains certain negative covenants that, among other things, restrict Kraton's ability, subject to certain exceptions, to incur additional indebtedness, grant liens on its assets, undergo fundamental changes, make investments, sell assets, make acquisitions, engage in sale and leaseback transactions, make restricted payments, engage in transactions with its affiliates, amend or modify certain agreements and charter documents and change its fiscal year. The covenants also restrict our activities. Kraton is required to maintain a fiscal quarter end interest coverage ratio of at least 2.75:1.00 through December 31, 2009; and of at least 3.00:1.00 beginning March 31, 2010 and continuing thereafter. In addition, Kraton is required to maintain a fiscal quarter end leverage ratio not to exceed 4.00 beginning December 31, 2009 and continuing thereafter.

As of December 31, 2009, we were in compliance with the applicable financial ratios in the senior secured credit facility and the other covenants contained in the senior secured credit facility and the indentures governing the senior subordinated notes.

Index to Financial Statements

**KRATON PERFORMANCE POLYMERS, INC.**

**Notes to Consolidated Financial Statements (Continued)**

On January 14, 2008, we received an equity investment of \$10.0 million, of which \$9.6 million was included in the financial covenant calculation for the twelve-month period ending December 31, 2007 and was included in the fiscal quarter covenant calculations through the fiscal quarter ending September 30, 2008 pursuant to the equity cure provisions included in the Credit Agreement.

**(b) Senior Discount Notes Due July 15, 2014** As part of a refinancing of indebtedness on November 2, 2004, Polymer Holdings issued the 12% discount notes. The following is a summary of the material terms of the 12% discount notes. This description does not purport to be complete and is qualified, in its entirety, by reference to the provisions of the indenture governing the 12% discount notes.

**Interest.** No cash interest accrued on the 12% discount notes prior to January 15, 2009. Thereafter, cash interest on the 12% discount notes will accrue and be payable semi-annually in arrears on January 15 and July 15 of each year, commencing on July 15, 2009, at a rate of 12.000% per annum.

**Accretion.** The 12% discount notes were issued at a substantial discount to their principal amount at maturity and generated gross proceeds of approximately \$91.9 million. The accreted value of each 12% discount note increased on a daily basis from the date of issuance until January 15, 2009, at a rate of 12% per annum, reflecting the accrual of non-cash interest, such that the accreted value on January 15, 2009, equals the principal amount at maturity.

**Guarantees.** None of Polymer Holdings' subsidiaries guarantee the 12% discount notes.

**Holding Company Structure and Ranking.** Kraton Performance Polymers is a holding company and does not have any material assets or operations other than ownership of Kraton's capital stock. All of its operations are conducted through Kraton and Kraton's subsidiaries and, therefore, Kraton Performance Polymers will be dependent upon Kraton's cash flow and the cash flow of our subsidiaries to meet its obligations under the 12% discount notes. As a result of the holding company structure, any right of Kraton Performance Polymers and its creditors, including the holders of the 12% discount notes, to participate in the assets of any of its subsidiaries upon such subsidiary's liquidation or reorganization will be structurally subordinated to the claims of that subsidiary's creditors and holders of preferred stock of such subsidiary, if any. In addition, in the event of the bankruptcy, liquidation, reorganization or other winding up of Kraton Performance Polymers, or upon a default in payment with respect to, or the acceleration of, any indebtedness under the senior secured credit facility or other secured indebtedness of Kraton Performance Polymers, the assets of Kraton Performance Polymers will be available to pay obligations on the 12% discount notes only after all secured indebtedness has been repaid from such assets.

**Optional Redemption.** Polymer Holdings may elect to redeem the 12% discount notes at certain predetermined redemption prices, plus accrued and unpaid interest.

**Covenants.** The 12% discount notes contain certain affirmative covenants including, among others, to furnish the holders of 12% discount notes with financial statements and other financial information and to provide the holders of 12% discount notes notice of material events.

The 12% discount notes contain certain negative covenants including limitations on indebtedness, limitations on restricted payments, limitations on restrictions on distributions from certain subsidiaries, limitations on lines of business and merger and consolidations.

As of December 31, 2009, Polymer Holdings was in compliance with all covenants under the 12% discount notes.

Index to Financial Statements**KRATON PERFORMANCE POLYMERS, INC.****Notes to Consolidated Financial Statements (Continued)**

**Exchange Offer.** On October 20, 2005, Polymer Holdings completed an offer to exchange all of its outstanding 12% discount notes issued under an exemption from the registration requirement of the Securities Act, for notes registered under the Securities Act. In this offer, 100% of the outstanding notes issued under the exemptions from registration were tendered and exchanged for registered notes. The registered notes are identical to the unregistered notes, except that the registered notes do not carry transfer restrictions.

**(c) Senior Subordinated Notes Due January 15, 2014.** On December 23, 2003, Kraton and Kraton Polymers Capital Corporation issued the 8.125% Notes in an aggregate principal amount of \$200.0 million. The 8.125% Notes are subject to the provisions for mandatory and optional prepayment and acceleration and are payable in full on January 15, 2014. Polymer Holdings and each of Kraton Polymers U.S. LLC and Elastomers Holdings LLC, which we refer to collectively as the Subsidiary Guarantors, have guaranteed the 8.125% Notes. The amount of 8.125% Notes outstanding at December 31, 2009 and 2008, was \$163 million and \$200.0 million.

**Interest.** The 8.125% Notes bear interest at a fixed rate of 8.125% per annum. Interest is payable semi-annually on January 15 and July 15.

**Optional Redemption.** Kraton may redeem all or a part of the senior subordinated notes at the redemption prices (expressed as percentages of principal amount) set forth below plus accrued and unpaid interest, if any, on the Notes redeemed to the applicable redemption date.

| Year                | Percentage |
|---------------------|------------|
| 2010                | 102.708%   |
| 2011                | 101.354%   |
| 2012                | 100.000%   |
| 2013 and thereafter | 100.000%   |

**Purchase of a Portion of the Senior Subordinated Notes.** In April 2009, TJ Chemical purchased approximately \$6.3 million face value of the senior subordinated notes for cash consideration of \$2.5 million, which included accrued interest of \$0.1 million. Immediately upon purchasing the senior subordinated notes, TJ Chemical contributed the purchased notes to us, and we in turn contributed the notes to Kraton. No equity interest or other consideration was issued in exchange for the contribution of the senior subordinated notes, although equity of each of Kraton Performance and Kraton was increased by an amount equal to the cash consideration paid by TJ Chemical. Kraton holds the senior subordinated notes as treasury bonds. Also in April 2009, Kraton purchased approximately \$0.7 million face value of the senior subordinated notes for cash consideration of \$0.3 million which Kraton is holding as treasury bonds. We recorded a gain of approximately \$4.3 million on the extinguishment of debt in the quarter ended June 30, 2009.

On March 16, 2009, Kraton purchased and retired \$30 million face value of the senior subordinated notes for cash consideration of \$10.9 million, which included accrued interest of \$0.4 million. We recorded a gain of approximately \$19.5 million in the quarter ending March 31, 2009 related to the purchase and retirement of these senior subordinated notes.

**Covenants.** The 8.125% Notes contain certain affirmative covenants including, among others, covenants to furnish the holders of the 8.125% Notes with financial statements and other financial information and to provide the holders of the 8.125% Notes notice of material events.

The 8.125% Notes contain certain negative covenants including limitations on indebtedness, limitations on restricted payments, limitations on restrictions on distributions from certain subsidiaries, limitations on lines of businesses and mergers and consolidations. As of December 31, 2009, we were in compliance with all covenants under the 8.125% Notes.

**Index to Financial Statements****KRATON PERFORMANCE POLYMERS, INC.****Notes to Consolidated Financial Statements (Continued)**

(d) *Debt Maturities.* The estimated remaining principal payments on our outstanding total debt as of December 31, 2009, are as follows:

|                     | <b>Principal<br/>Payments<br/>(in thousands)</b> |
|---------------------|--|
| <b>December 31:</b> |  |
| 2010                | \$ 2,304   |
| 2011                | \$ 2,304   |
| 2012                | \$ 109,137                                       |
| 2013                | \$ 107,984                                       |
| 2014 and thereafter | \$ 163,250                                       |
| <b>Total debt</b>   | <b>\$ 384,979</b>                                |

**5. Deferred Financing Costs**

We capitalize financing fees and other related costs and amortize them to interest expense over the term of the related debt instrument using the effective interest method. We amortized \$4.1 million, \$2.1 million and \$2.7 million in deferred financing costs in the years ended 2009, 2008 and 2007, respectively. In December 2009, we made a \$100.0 million pre-payment of outstanding indebtedness under the Term Loans, which resulted in the write off of approximately \$1.5 million of deferred financing cost. In June 2008 we made a \$10.0 million voluntary prepayment of outstanding indebtedness under the Term Loans, which resulted in the write off of approximately \$0.2 million of deferred financing cost. In addition, during the year ended December 31, 2007, we made voluntary prepayments under the Term Loans in the amount of \$40.0 million, which resulted in the write off of approximately \$0.6 million of deferred financing cost.

We incurred approximately \$3.2 million of fees in connection with the amendment to our Term Loan and Revolving loan in 2009, and these fees were recorded as deferred financing costs during the year ended December 31, 2009. In 2008, we incurred fees of approximately \$1.2 million associated with preliminary analysis of refinancing options associated with our Credit Agreement and recorded a charge of \$1.2 million to selling, general, and administrative expense in the consolidated statements of Operations as we determined our refinancing efforts were not probable due to current market condition.

**6. Income Taxes**

Income taxes are recorded utilizing an asset and liability approach. This method gives consideration to the future tax consequences associated with the differences between the financial accounting basis and tax basis of the assets and liabilities, and the ultimate realization of any deferred tax asset resulting from such differences.

**Index to Financial Statements****KRATON PERFORMANCE POLYMERS, INC.****Notes to Consolidated Financial Statements (Continued)**

The provision (benefit) for income taxes on income from continuing operations is comprised of the following:

|                                     | 2009              | December 31,<br>2008<br>(in thousands) | 2007            |
|-------------------------------------|-------------------|--|-----------------|
| <b>Current tax provision:</b>       |                   |  |                 |
| U.S.                                | \$ 422            | \$ 262                                 | \$ 12           |
| Foreign                             | 8,239             | 13,614                                 | 4,589           |
| Total                               | 8,661             | 13,876                                 | 4,601           |
| <b>Deferred tax provision:</b>      |                   |  |                 |
| U.S.                                | (285)             | (51)                                   | 2,491           |
| Foreign                             | (9,743)           | (5,394)                                | (972)           |
| Total                               | (10,028)          | (5,445)                                | 1,519           |
| <b>Income tax expense (benefit)</b> | <b>\$ (1,367)</b> | <b>\$ 8,431</b>                        | <b>\$ 6,120</b> |

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes, as well as operating loss and tax credit carryforwards. In connection with the acquisition, the book basis of foreign assets and liabilities was stepped-up to their estimated fair market value.

Income (loss) before income taxes is comprised of the following:

|   | 2009       | December 31,<br>2008<br>(in thousands) | 2007        |
|---|------------|--|-------------|
| <b>Income (loss) before income taxes:</b> |            |  |             |
| U.S.                                      | \$ 9,656   | \$ 7,098                               | \$ (29,205) |
| Foreign                                   | (11,313)   | 29,752                                 | (8,424)     |
| Total                                     | \$ (1,657) | \$ 36,850                              | \$ (37,629) |

**Index to Financial Statements****KRATON PERFORMANCE POLYMERS, INC.****Notes to Consolidated Financial Statements (Continued)**

The tax effects of temporary differences that gave rise to significant components of deferred tax liabilities and assets are as follows:

|   | <b>December 31,</b>   |                  |
|---|-----------------------|------------------|
|   | <b>2009</b>           | <b>2008</b>      |
|   | <b>(in thousands)</b> |                  |
| <b>Deferred tax liabilities:</b>            |                       |                  |
| Property, plant and equipment               | \$ 96,424             | \$ 100,104       |
| Identifiable intangibles                    | 2,986                 | 4,921            |
| <b>Total deferred tax liabilities</b>       | <b>99,410</b>         | <b>105,025</b>   |
| <b>Deferred tax assets:</b>                 |                       |                  |
| Net operating loss carryforward             | (116,438)             | (113,519)        |
| Inventory                                   | (3,270)               | (3,563)          |
| Exchange rate differences                   | (236)                 | (1,210)          |
| Interest rate swaps                         | (1,097)               | (2,022)          |
| Pension accrual                             | (15,971)              | (18,716)         |
| Other Accruals and Reserves                 | (8,976)               | (9,465)          |
| Interest                                    |                       | (31)             |
| <b>Total deferred tax assets</b>            | <b>(145,988)</b>      | <b>(148,526)</b> |
| Valuation allowance for deferred tax assets | 56,956                | 63,677           |
| <b>Net deferred tax liabilities</b>         | <b>\$ 10,378</b>      | <b>\$ 20,176</b> |

|   | <b>December 31</b>    |                  |
|---|-----------------------|------------------|
|   | <b>2009</b>           | <b>2008</b>      |
|   | <b>(in thousands)</b> |                  |
| <b>Net deferred tax liabilities of:</b> |                       |                  |
| Current deferred tax assets             | \$ (14,730)           | \$ (24,196)      |
| Non-current deferred tax assets         | (168,979)             | (166,930)        |
| Current deferred tax liabilities        | 11,624                | 9,418            |
| Non-current deferred tax liabilities    | 182,463               | 201,884          |
| <b>Net deferred tax liabilities</b>     | <b>\$ 10,378</b>      | <b>\$ 20,176</b> |

The provision for income taxes differs from the amount computed by applying the U.S. statutory income tax rate to income from continuing operations before income taxes for the reasons set forth below:

|  | <b>2009</b>           | <b>December 31,<br/>2008</b> | <b>2007</b> |
|--|-----------------------|------------------------------|-------------|
|  | <b>(in thousands)</b> |                              |             |



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|   |            |           |             |
|---|------------|-----------|-------------|
| Income Taxes at the Statutory Rate                        | \$ (580)   | \$ 12,897 | \$ (13,171) |
| Foreign Tax Rate Differential                             | (97)       | (3,294)   | 3,331       |
| State Taxes   | (225)      | (86)      | (3,012)     |
| Permanent Differences Netherlands Participation Exemption | (784)      | (903)     |             |
| Permanent Differences Other                               | (48)       | 682       | (144)       |
| Differences in Foreign Earnings Remitted                  | 4,165      | 6,354     | 4,043       |
| Tax Credits   | (122)      |           |             |
| Other   | (189)      |           |             |
| Tax Benefit Related to Foreign Losses                     | (2,597)    |           |             |
| Change in Valuation Allowance and Uncertain Tax Positions | (890)      | (7,219)   | 15,073      |
| Income Tax Expense (Benefit)                              | \$ (1,367) | \$ 8,431  | \$ 6,120    |

F-25

**Index to Financial Statements****KRATON PERFORMANCE POLYMERS, INC.****Notes to Consolidated Financial Statements (Continued)**

|   | December 31, |              |                |
|---|--------------|--------------|----------------|
|   | 2009         | 2008         | 2007           |
| Income Taxes at the Statutory Rate                        | 35.0%        | 35.0%        | 35.0%          |
| Foreign Tax Rate Differential                             | 5.9%         | (8.9)%       | (8.9)%         |
| State Taxes   | 13.6%        | (0.2)%       | 8.0%           |
| Permanent Differences Netherlands Participation Exemption | 47.3%        | (2.5)%       | 0.0%           |
| Permanent Differences Other                               | 2.9%         | 1.9%         | 0.4%           |
| Differences in Foreign Earnings Remitted                  | (251.4)%     | 17.2%        | (10.7)%        |
| Tax Credits   | 7.4%         | 0.0%         | 0.0%           |
| Other   | 11.4%        | 0.0%         | 0.0%           |
| Tax Benefit Related to Foreign Losses                     | 156.7%       | 0.0%         | 0.0%           |
| Change in Valuation Allowance and Uncertain Tax Positions | 53.7%        | (19.6)%      | (40.1)%        |
| <b>Effective Tax Rate</b>                                 | <b>82.5%</b> | <b>22.9%</b> | <b>(16.3)%</b> |

As of December 31, 2009, we had \$331.3 million of operating loss carryforwards for income tax purposes, of which \$233.8 million relates to the United States and the remaining \$97.5 million relates to foreign tax jurisdictions. The United States operating loss carryforwards will expire in 2024, 2025, 2026 and 2027, if not utilized in prior years. We anticipate taxable income in future years that will allow us to utilize the carryforwards that have not had a valuation allowance placed against them.

As of December 31, 2009 and 2008, a valuation allowance of \$57.0 million and \$63.7 million, respectively, had been recorded related to certain deferred tax assets. 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. The ultimate realization of the deferred tax assets depends on the ability to generate sufficient taxable income of the appropriate character in the future and in the appropriate taxing jurisdictions. We have provided a valuation allowance for operating loss carryforwards and deferred tax assets in certain jurisdictions.

In assessing realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible. Based upon management's expectations at December 31, 2009, management believes it is more likely than not, that we will realize the benefit of the deferred tax assets, net of the existing valuation allowances.

We provide for taxes in certain situations where assessments have not been received. In those situations, we consider it probable that the taxes ultimately payable will exceed the amounts reflected in filed tax returns; accordingly, taxes are provided in those situations under the guidance in ASC 740-10-05, Accounting for Uncertainty in Income Taxes, and are included in both income taxes in current liabilities and in deferred income taxes and other liabilities in the consolidated balance sheets.

Effective January 1, 2007, we adopted the principles of ASC 740-10-05, Accounting for Uncertainty in Income Taxes, which prescribes the minimum recognition threshold a tax position taken or expected to be taken in a tax return is required to meet before being recognized in the financial statements. It also provides guidance for derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. As a result of the implementation of ASC 740-10-05, we recognized no change in the liability for unrecognized tax benefits or accrued interest and penalties. We file income tax returns in the U.S. federal jurisdiction, and various state and foreign jurisdictions. As of December 31, 2009, our 2005 through 2008 U.S. federal income tax returns remain open to examination. In addition, open tax years to state and foreign jurisdictions remain subject to examination.

Index to Financial Statements**KRATON PERFORMANCE POLYMERS, INC.****Notes to Consolidated Financial Statements (Continued)**

As of January 1, 2009, we had total unrecognized tax benefits of approximately \$1.1 million. During the year ended December 31, 2009, we had a change in certain tax positions mainly related to prior tax periods. The increase of \$0.1 million in these tax positions was primarily due to recognizing additional reserve needs in connection with an ongoing tax audit in Asia. As of December 31, 2009, we estimated \$ 1.2 million in unrecognized tax benefits, that if recognized, would impact the effective tax rate. We recognize interest and penalties related to unrecognized tax benefits within the provision for income taxes in our consolidated statement of operations. During the year ended December 31, 2009, we recognized additional interest and penalties charges related to unrecognized tax benefits. As of January 1, 2009, we believe that no current tax positions that have resulted in unrecognized tax benefits will significantly increase or decrease within one year. As of the year ended December 31, 2009, no material changes, other than the tax audit related charges mentioned above, have occurred in our estimates or expected events related to anticipated changes in our unrecognized tax benefits.

The following presents a rollforward of our unrecognized tax benefits and associated interest and penalties.

|                                      | <b>Unrecognized<br/>Tax<br/>Benefits</b> | <b>Interest and<br/>Penalties</b> |
|--------------------------------------|--|-----------------------------------|
|                                      | <b>(in thousands)</b>                    |                                   |
| Balance at January 1, 2009           | \$ 1,144                                 | \$ 83                             |
| Increase in prior year tax positions | 11                                       | 38                                |
| Balance at December 31, 2009         | \$ 1,155                                 | \$ 121                            |

**7. Employee Benefits**

*(a) U.S. Retirement Benefit Plans.* We have a U.S noncontributory defined benefit pension plan in the United States, which covers all salaried and hourly wage employees in the United States, who were employed by us on or before December 31, 2005. Employees who begin their employment with us after December 31, 2005 are not covered by our U.S. noncontributory defined benefit pension plan. The benefits under this plan are based primarily on years of service and employees' pay near retirement. For our employees who were employed as of March 1, 2001 and who: (1) were previously employed by Shell Chemicals; and (2) elected to transfer their pension assets to us, we consider the total combined Shell Chemicals and Kraton service when calculating the employee's pension benefit. For those employees who: (1) elected to retire from Shell Chemicals; or (2) elected not to transfer their pension benefit, only Kraton service (since March 1, 2001) is considered when calculating benefits.

Index to Financial Statements**KRATON PERFORMANCE POLYMERS, INC.****Notes to Consolidated Financial Statements (Continued)**

The 2009 measurement date of the plans' assets and obligations was December 31, 2009. Based on the funded status of our defined benefit pension plan as of December 31, 2009, we reported an increase in our accumulated other comprehensive income of approximately \$12.3 million and a related decrease in accrued pension obligations. Accrued pension obligations are included in long-term liabilities on our consolidated balance sheet. Information concerning the pension obligation, plan assets, amounts recognized in our financial statements and underlying actuarial assumptions are as follows:

|  | December 31,   |             |
|--|----------------|-------------|
|  | 2009           | 2008        |
|  | (in thousands) |             |
| <b>Change in benefit obligation</b>            |                |             |
| Benefit obligation at beginning of year        | \$ 82,163      | \$ 62,061   |
| Service cost                                   | 2,813          | 2,281       |
| Interest cost                                  | 4,690          | 4,275       |
| Benefits paid                                  | (2,086)        | (1,880)     |
| Actuarial (gain) loss                          | (10,691)       | 15,268      |
| Plan amendments                                |                | 158         |
| <br>   |                |             |
| Benefit obligation at end of year              | \$ 76,889      | \$ 82,163   |
| <b>Change in plan assets</b>                   |                |             |
| Fair value at beginning of year                | \$ 39,111      | \$ 46,329   |
| Actual return on plan assets                   | 9,106          | (14,313)    |
| Employer contributions                         | 4,190          | 8,974       |
| Benefits paid                                  | (2,086)        | (1,880)     |
| <br>   |                |             |
| Fair value at end of year                      | \$ 50,321      | \$ 39,110   |
| <br>   |                |             |
|  | December 31,   |             |
|  | 2009           | 2008        |
| <b>Development of net amount recognized</b>    |                |             |
| Funded status                                  | \$ (26,568)    | \$ (43,052) |
| Unrecognized net prior service cost            |                |             |
| Unrecognized actuarial loss                    |                |             |
| <br>   |                |             |
| Net amount recognized in long-term liabilities | \$ (26,568)    | \$ (43,052) |

The projected benefit obligation, fair value of plan assets and accumulated benefit obligation for the Plan with accumulated benefit obligations in excess of plan assets were \$76.9 million, \$50.3 million and \$67.7 million, respectively, as of December 31, 2009 and \$82.2 million, \$39.1 million and \$70.0 million, respectively, as of December 31, 2008.

Net periodic pension costs consist of the following components:

|  | December 31, |      |
|--|--------------|------|
|  | 2009         | 2008 |
|  | 2009         | 2007 |

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|   | (in thousands) |          |          |
|---|----------------|----------|----------|
| Service cost benefits earned during the period        | \$ 2,813       | \$ 2,281 | \$ 2,561 |
| Interest on prior year's projected benefit obligation | 4,690          | 4,275    | 3,842    |
| Expected return on plan assets                        | (4,680)        | (4,084)  | (3,646)  |
| Amortization of net actuarial                         | 514            |          |          |
| Recognized curtailment loss                           |                |          |          |
| Recognized loss due to special term benefits          |                | 158      |          |
| Net periodic pension costs                            | \$ 3,337       | \$ 2,630 | \$ 2,757 |

F-28

**Index to Financial Statements****KRATON PERFORMANCE POLYMERS, INC.****Notes to Consolidated Financial Statements (Continued)**

Discount rates are determined annually and are based on rates of return of high-quality long-term fixed income securities currently available and expected to be available during the maturity of the pension benefits.

|   | <b>December 31,</b> |             |
|---|---------------------|-------------|
|   | <b>2009</b>         | <b>2008</b> |
| <b>Weighted average assumptions used to determine benefit obligations</b>   |                     |             |
| Measure date  | 12/31/2009          | 12/31/2008  |
| Discount rate   | 6.38%               | 5.73%       |
| Rates of increase in salary compensation level                              | 3.00%               | 3.70%       |
| <b>Weighted average assumptions used to determine periodic benefit cost</b> |                     |             |
| Discount rate   | 5.73%               | 6.64%       |
| Rates of increase in salary compensation level                              | 3.70%               | 3.50%       |
| Expected long-term rate of return on plan assets                            | 8.50%               | 8.50%       |

The expected long-term rate of return on assets assumption is derived from a study conducted by our actuaries. The study includes a review of anticipated future long-term performance of individual asset classes and consideration of the appropriate asset allocation strategy given the anticipated requirements of the plan to determine the average rate of earnings expected on the funds invested to provide for the pension plan benefits. While the study gives appropriate consideration to recent fund performance and historical returns, the assumption is primarily a long-term, prospective rate. Based on our most recent study, the expected long-term return assumption for our U.S. plan effective for the current year will remain at 8.5%.

**Plan Assets.** We maintain target allocation percentages among various asset classes based on an investment policy established for the pension plan. The target allocation is designed to achieve long term objectives of return, while mitigating against downside risk and considering expected cash flows. The current weighted-average target asset allocation is as follows: equity securities 64.0%, debt securities 35.5%, real estate 0.0%, and other 0.5%. Our investment policy is reviewed from time to time to ensure consistency with our long term objective.

Our pension plan asset allocations at December 31, 2009, and 2008, by asset category are as follows:

| <b>Asset Category</b> | <b>Percentage of Plan Assets</b> |               |
|-----------------------|----------------------------------|---------------|
|                       | <b>at December 31</b>            |               |
|                       | <b>2009</b>                      | <b>2008</b>   |
| Equity securities     | 64.6%                            | 62.5%         |
| Debt securities       | 34.9%                            | 37.0%         |
| Real estate           | 0.0%                             | 0.0%          |
| Other                 | 0.5%                             | 0.5%          |
| <b>Total</b>          | <b>100.0%</b>                    | <b>100.0%</b> |

Equity securities include our common stock in the amounts of \$0 (0 percent of total assets) and \$0 (0 percent of total assets) at December 31, 2009, and 2008, respectively.

Index to Financial Statements**KRATON PERFORMANCE POLYMERS, INC.****Notes to Consolidated Financial Statements (Continued)**

The fair value of the Company's pension plan assets at December 31, 2009, by asset category are as follows:

|                                      | <b>Pension Plan Assets</b>        |   |  |  |
|--------------------------------------|-----------------------------------|---|--|--|
|                                      | <b>Fair Value Measurements at</b> |   |  |  |
|                                      | <b>December 31, 2009</b>          |   |  |  |
|                                      | <b>Total</b>                      | <b>Quoted Prices<br/>In Active Markets<br/>Identical Assets<br/>(Level 1)</b> | <b>Significant<br/>Observable<br/>Inputs<br/>(Level 2)</b> | <b>Significant<br/>Unobservable<br/>Inputs<br/>(Level 3)</b> |
|                                      | <b>(In thousands)</b>             |   |  |  |
| Money Market Mutual Fund             | \$ 244                            | \$ 244  | \$   | \$   |
| Commingled Pool Equity               |                                   |   |  |  |
| FMTC US Equity Index Pool(d)         | 6,224                             |   | 6,224  |  |
| Pyramis Intl Growth Com Pool(e)      | 3,015                             |   | 3,015  |  |
| Pyramis Quant LG Cap Cor Com Pool(f) | 2,547                             |   | 2,547  |  |
| Pyramis Select Intl Equity(g)        | 5,486                             |   | 5,486  |  |
| Pyramis Small Company Com Pool(h)    | 5,008                             |   | 5,008  |  |
| Pyramis US Total Market Equity(i)    | 10,230                            |   | 10,230   |  |
| <b>Total</b>                         | <b>32,510</b>                     |   | <b>32,510</b>  |  |
| Commingled Pool Debt                 |                                   |   |  |  |
| Pyramis EMG MKT Debt Com Pool(a)     | 1,022                             |   | 1,022  |  |
| Pyramis High Yield Bond Com Pool(b)  | 2,095                             |   | 2,095  |  |
| Pyramis Long Duration(c)             | 14,451                            |   | 14,451   |  |
| <b>Total</b>                         | <b>17,568</b>                     |   | <b>17,568</b>  |  |
| <b>Total</b>                         | <b>\$ 50,322</b>                  | <b>\$ 244</b>   | <b>\$ 50,078</b>   | <b>\$</b>  |

- (a) Portfolio with the primary objective to achieve superior total returns primarily through investments in debt securities of emerging countries.
- (b) Portfolio with the primary objective to achieve superior total returns through investments in a universe of lower-rated and non-rated debt securities providing high current income.
- (c) Portfolio with the primary objective to generate returns that exceed the Barclays Capital® US Long Government/Credit Bond Index through investments in investment-grade fixed-income securities and commingled vehicles.
- (d) Portfolio with the primary objective to provide investment results that correspond to the total return performance of common stocks publicly traded in the United States.
- (e) Portfolio with the primary objective to seek long-term growth of capital primarily through investments in foreign equity securities.
- (f) Portfolio with the primary objective to consistently provide excess return over the S&P 500® Index through active stock selection while maintaining portfolio risk characteristics similar to the benchmark.
- (g) Portfolio with the primary objective to seek long-term growth of capital primarily through investments in foreign securities.
- (h) Portfolio with the primary objective to achieve long-term growth of capital, principally by investing in the equity securities of smaller, growing companies.
- (i) Portfolio with the primary objective to provide excess return over a market cycle relative to the Dow Jones U.S. Total Stock Market Index® (Index), an unmanaged index of all U.S. headquartered companies maintained by Whilshire Associates, while maintaining similar style characteristics and sector weights.

*Contributions.* We expect to contribute \$3.2 million to our pension plan in 2010.

F-30



Index to Financial Statements

## KRATON PERFORMANCE POLYMERS, INC.

## Notes to Consolidated Financial Statements (Continued)

*Estimated Future Benefit Payments.*

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

|                 | (in thousands) |
|-----------------|----------------|
| 2010            | 2,202          |
| 2011            | 2,382          |
| 2012            | 2,572          |
| 2013            | 2,845          |
| 2014            | 3,230          |
| Years 2015-2019 | 23,120         |
|                 | \$ 36,351      |

**(b) Other Retirement Benefit Plans.** Certain employees are eligible to participate in a non-qualified defined benefit restoration plan and/or a non-qualified defined contribution restoration plan ( benefit restoration plans ) which are intended to restore certain benefits under the noncontributory defined benefit pension plan in the United States and the Kraton Savings Plan in the United States, respectively, which would otherwise be lost due to certain limitations imposed by law on tax-qualified plans. We made \$0.9 million in contributions to the benefit restoration plans for the years ended December 31, 2009 and no contribution for the year ended December 31, 2008 and 2007. As of December 31, 2009 and 2008, amounts recognized in the statement of financial position as a component of long-term liabilities for the benefit restoration plans were \$0.4 million and \$1.0 million, respectively.

We have established a defined benefit plan in Japan designed to be equivalent to the plan previously provided by Shell Chemicals and covers substantially all Japan employees. Our contributions to the plan for the years ended December 31, 2009, 2008 and 2007 were \$0.19 million, \$0 million, and \$0.02 million, respectively. As of December 31, 2009, 2008, and 2007 amounts recognized in the statement of financial position as a component of long-term liabilities for the defined benefit plan were \$1.3 million, \$1.3 million and \$0.9 million, respectively.

**(c) Postretirement Benefits Other Than Pensions.** Health and welfare benefits are provided to benefit eligible employees in the United States who retire from Kraton and were employed by us prior to January 1, 2006. Retirees under the age of 65 are eligible for the same medical, dental, and vision plans as active employees, but with an annual cap on premiums that varies based on years of service and ranges from \$7,000 to \$10,000 per employee. Our subsidy schedule for medical plans is based on accredited service at retirement. Retirees are responsible for the full cost of premiums for postretirement dental and vision coverage. In general, the plans stipulate that health and welfare benefits are paid as covered expenses are incurred. We accrue the cost of these benefits during the period in which the employee renders the necessary service.

Employees who were retirement eligible as of February 28, 2001, have at their option the right to participate in either Shell Chemicals or Kraton postretirement health and welfare plans.

ASC 715, Compensation-Retirement Benefits, requires that we measure the plans' assets and obligations that determine our funded status as of the end of the fiscal year. The 2009 measurement date of the plans' assets and obligations was December 31, 2009. We are also required to recognize as a component of accumulated other comprehensive income the changes in funded status that occurred during the year that are not recognized as part of new periodic benefit cost.

Based on the funded status of our postretirement benefit plan as of December 31, 2009, we reported a decrease of approximately \$0.8 million in accrued postretirement obligations.



**Index to Financial Statements****KRATON PERFORMANCE POLYMERS, INC.****Notes to Consolidated Financial Statements (Continued)**

It has been determined that the plan's retiree prescription plan is actuarially equivalent for the Medicare Part D subsidy. The accumulated postretirement benefit obligation for the year ended December 31, 2009 decreased approximately \$3.2 million due to the inclusion of the Medicare Part D subsidy.

Information concerning the plan obligation, the funded status and amounts recognized in our financial statements and underlying actuarial assumptions are as follows:

|   | <b>December 31,</b>   |             |
|---|-----------------------|-------------|
|   | <b>2009</b>           | <b>2008</b> |
|   | <b>(in thousands)</b> |             |
| <b>Change in benefit obligation:</b>      |                       |             |
| Benefit obligation at beginning of period | \$ 16,138             | \$ 13,341   |
| Service cost                              | 392                   | 332         |
| Interest cost                             | 1,058                 | 871         |
| Benefits paid                             | (614)                 | (772)       |
| Actuarial loss                            | 1,499                 | 2,102       |
| Plan amendments                           |                       | 264         |
| <br>                                      |                       |             |
| Benefit obligation at end of period       | \$ 18,473             | \$ 16,138   |
| <b>Reconciliation of plan assets(1):</b>  |                       |             |
| Employer contributions                    | \$ 614                | \$ 772      |
| Benefits paid                             | (614)                 | (772)       |
|   | \$                    | \$          |

- (1) As part of the Ripplewood Transaction, Shell Chemicals has committed to a future cash payment related to retiree medical expenses based on a specified dollar amount per employee, if certain contractual commitments are met. We have recorded an asset of approximately \$6.6 million and \$6.5 million as our estimate of the present value of this commitment as of December 31, 2009 and 2008, respectively.

|  | <b>December 31,</b>   |             |
|--|-----------------------|-------------|
|  | <b>2009</b>           | <b>2008</b> |
|  | <b>(in thousands)</b> |             |
| <b>Development of net amount recognized:</b> |                       |             |
| Funded status                                | \$ (18,474)           | \$ (16,138) |
| Unrecognized cost: Actuarial gain            |                       |             |
| <br>   |                       |             |
| Amount recognized in long-term liabilities   | \$ (18,474)           | \$ (16,138) |

Net periodic benefit costs consist of the following components:

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|                                    | 2009     | December 31,<br>2008<br>(in thousands) | 2007     |
|------------------------------------|----------|--|----------|
| Service cost                       | \$ 392   | \$ 332                                 | \$ 357   |
| Interest cost                      | 1,058    | 871                                    | 776      |
| Amortization of net actuarial loss | 231      |  |          |
| Restructuring costs                |          | 264                                    |          |
| Net periodic benefit costs         | \$ 1,681 | \$ 1,467                               | \$ 1,133 |

F-32

**Index to Financial Statements****KRATON PERFORMANCE POLYMERS, INC.****Notes to Consolidated Financial Statements (Continued)**

|   | <b>December 31,</b> |             |
|---|---------------------|-------------|
|   | <b>2009</b>         | <b>2008</b> |
| <b>Weighted average assumptions used to determine benefit obligations</b> |                     |             |
| Measurement date  | 12/31/2009          | 12/31/2008  |
| Discount rate   | 6.17%               | 5.76%       |
| Rates of increase in salary compensation level                            | N/A                 | N/A         |
| <b>Weighted average assumptions used to net periodic benefit cost</b>     |                     |             |
| Discount rate   | 5.76%               | 6.49%       |
| Rates of increase in salary compensation level                            | N/A                 | N/A         |
| Expected long-term rate of return on plan assets                          | N/A                 | N/A         |

|   | <b>December 31,</b> |             |
|---|---------------------|-------------|
|   | <b>2009</b>         | <b>2008</b> |
| <b>Assumed health care cost trend rates</b>                                       |                     |             |
| Health care cost trend rate assumed for next year                                 | 8.00%               | 8.75%       |
| Rate to which the cost trend rate is assumed to decline (the ultimate trend rate) | 4.00%               | 5.00%       |
| Year that the rate reaches the ultimate trend rate                                | 2014                | 2014        |

The discount rate for 2009 was based in part on the average Moody's Aa Corporate Bond Yield and the average Citigroup Pension Liability Index, which were 5.49% and 5.96%, respectively. The Fidelity Investments bond modeler was used to compare the expected future cash outflows to the bonds included in the indices noted above.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A 1%-point change in assumed health care cost trend rates would have the following effect (in thousands):

|   | <b>1% Increase</b> | <b>1% Decrease</b> |
|---|--------------------|--------------------|
| Effect on total of service and interest cost components | \$ 52              | \$ (76)            |
| Effect on postretirement benefit obligation             | 622                | (931)              |

**(d) Kraton Savings Plan.** The Kraton Savings Plan, as adopted on March 1, 2001, covers substantially all U.S. employees, including executive officers. We amended and restated the Savings Plan in April 2002, to comply with changes in legislation in 2002, and subsequently submitted and received an IRS determination letter.

Through automatic payroll deduction, participants have the option to defer up to 60% of eligible earnings in any combination of pretax and/or post-tax contributions. Contributions are subject to annual dollar limitations set forth in the Internal Revenue Code. Effective January 1, 2006 we modified the Kraton Savings Plan to have three types of employer contributions. After completing one year of service, we will make a matching contribution of 50% of the first 6% contributed by the employee and after completing five years of service we will make a matching contribution of 100% of the first 6% contributed by the employee. For employees who have completed nine or more years of service and elected to remain a participant in the pension plan, we made a transition contribution of 4% during 2006 and reduced transition contribution of 2% in 2007. For employees who elected to lock in their Kraton pension benefits as of December 31, 2005, we make enhanced employer contributions of 3% for employees who have less than five years of service and a 4% contribution for employees who have five or more years of service. For our employees who were employed as of February 28, 2001, and who were previously employed by Shell Chemicals, we recognize their Shell Chemicals years of service for purposes of determining employer contributions under our Plan. Overall, a participant may direct up to a maximum of 100% of eligible

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**Index to Financial Statements****KRATON PERFORMANCE POLYMERS, INC.****Notes to Consolidated Financial Statements (Continued)**

earnings to this Plan, but cannot exceed the IRS maximum limit for the combined total of employee and employer contributions. Our contributions to the plan for the year ended December 31, 2009, 2008 and 2007, were \$2.7 million, \$2.2 million, and \$2.7 million, respectively.

**(e) Membership Units.** Prior to the IPO, we provided certain key employees who held interests in us prior to the acquisition the opportunity to roll over their interests into membership units of Management LLC, which owned a corresponding number of membership units in TJ Chemical. Additional employees were also given the opportunity to purchase membership units in TJ Chemical through Management LLC at the original buy-in price. The membership units were subject to customary tag-along and drag-along rights, as well as a company call right in the event of termination of employment. In addition, pursuant to Messrs. Gregory and Fogarty employment agreements, on September 10, 2004 and June 15, 2005, TJ Chemical granted a notional restricted unit award with a fair value at the grant date of \$875,000 and \$300,000, to Messrs. Gregory and Fogarty, respectively. Each of these awards vested 20% on each of the first five anniversaries of their employment commencement dates, so long as Messrs. Gregory and Fogarty remain employed by us through the applicable vesting date. The actual membership units would not be distributed until the earlier of: (1) a change in control; or (2) the termination of either Messrs. Gregory and Fogarty's employment. TJ Chemical granted two restricted membership unit awards having a fair value at the grant date of \$200,000 and \$100,000 each to David Bradley. The award for \$200,000 vested 20% on each of the first five anniversaries of his employment commencement date (April 1, 2004), so long as Mr. Bradley remained employed by us through the applicable vesting date. The award for \$100,000 vests 20% on each of the first five anniversaries and commenced vesting, on February 1, 2006, so long as Mr. Bradley remains employed by us through the applicable vesting date. TJ Chemical granted a restricted membership unit award to Nicholas G. Dekker on October 6, 2006 having a fair value at the grant date of \$150,000. This award vested 20% on each of the first five anniversaries of his employment as our Chief Financial Officer and Vice President (October 6, 2006), for so long as Mr. Dekker remained employed by us through the applicable vesting date. In connection with their promotions, Messrs. Fogarty and Bradley were awarded additional restricted membership units in the amount of 600,000 and 300,000, respectively, on June 19, 2008. These restricted Membership Units vest 1/3 on each of the first three anniversaries of the grant date, so long as they remain employed through the applicable vesting date. The amount to Messrs. Gregory, Bradley, Fogarty and Dekker will be recognized in earnings over the vesting period on a straight-line basis.

In connection with his termination of employment, Mr. Gregory retained 151,000 membership units, and was paid out at a price of \$1.00 per unit for 149,000 units as part of his Separation Agreement. In connection with his termination of employment, Mr. Dekker was paid out at a price of \$1.00 per unit for his total units of \$50,000. As of December 31, 2008, there were 1,886,000 membership units of Management LLC issued and outstanding.

Effective as of the IPO, Management LLC transferred all outstanding grants of membership units to Polymer Holdings (now Kraton Performance Polymers, Inc). The outstanding equity and equity awards of Management LLC held by the employees were cancelled and converted into equity or equity awards of equal value of common shares of Kraton Performance Polymers, Inc. The remaining terms of all outstanding awards remained substantially the same, including with respect to vesting and forfeiture provisions.

**(f) TJ Chemical Holdings LLC 2004 Option Plan.** On September 9, 2004, TJ Chemical adopted an option plan, or the Option Plan, which allows for the grant to key employees, consultants, members and service providers of TJ Chemical and its affiliates, including us, of non-qualified options to purchase TJ Chemical membership units. The aggregate number of membership units with respect to which options may be granted under the Option Plan shall not exceed an amount representing 8% of the outstanding membership units and profits units of TJ Chemical on March 31, 2004, on a fully diluted basis. As of December 31, 2008 and 2007

**Index to Financial Statements**

**KRATON PERFORMANCE POLYMERS, INC.**

**Notes to Consolidated Financial Statements (Continued)**

there were 22,101,118 and 14,670,000 options granted and outstanding, respectively. All options granted in fiscal 2008, fiscal 2007 and fiscal 2006 had an exercise price of \$1 per membership unit, which is equal to or in excess of the fair value of the membership unit on the date of grant. The options generally vest in 20% annual increments from the date of grant. However, the Compensation Committee determined that a shorter vesting period was appropriate for grants made during the 2008 fiscal year and therefore options granted in 2008 were set to vest in increments of 1/3 over 3 years. With respect to directors, previous to 2008 options were exercisable in 50% increments annually on each of the first two anniversaries of the grant date, so long as the holder of the option is still a director on the vesting date. In 2008, options granted to directors were granted in increments of 1/3 over 3 years, except the Chairman who has a one year vesting period. The exercise price per membership unit shall equal the fair market value of a membership unit on the date of exercised. Upon a change in control, the options will become 100% vested if the participant's employment is terminated without cause or by the participant for good reason (as each term is defined in the Option Plan) within the 2-year period immediately following such change in control.

The Compensation Committee of Kraton Performance Polymers administers the Option Plan on behalf of TJ Chemical, including, without limitation, the determination of the individuals to whom grants will be made, the number of membership units subject to each grant and the various terms of such grants. The Committee will have the right to terminate all of the outstanding options at any time and pay the participants an amount equal to the excess, if any, of the fair market value of a membership unit as of such date over the exercise price with respect to such option, or the spread. Generally, in the event of a merger (except a merger where membership unit holders receive securities of another corporation), the options will pertain to and apply to the securities that the option holder would have received in the merger; and in the event of a dissolution, liquidation, sale of assets or any other merger, the Committee has the discretion to: (1) provide for an exchange of the options for new options on all or some of the property for which the membership units are exchanged (as may be adjusted by the Committee); (2) cancel and cash out the options (whether or not then vested) at the spread; or (3) provide for a combination of both. Generally, the Committee may make appropriate adjustments with respect to the number of membership units covered by outstanding options and the exercise price in the event of any increase or decrease in the number of membership units or any other corporate transaction not described in the preceding sentence.

On a termination of a participant's employment (other than without cause or by the participant for good reason within the 2-year period immediately following a change in control), unvested options automatically expire and vested options expire on the earlier of: (1) the commencement of business on the date the employment is terminated for cause; (2) 90 days after the date employment is terminated for any reason other than cause, death or disability; (3) 1-year after the date employment is terminated by reason of death or disability; or (4) the 10th anniversary of the grant date for such option.

Generally, pursuant to TJ Chemical's operating agreement, membership units acquired pursuant to the Option Plan are subject to customary tag-along and drag-along rights for the 180-day period following the later of a termination of employment and 6 months and 1-day following the date that units were acquired pursuant to the exercise of the option, TJ Chemical has the right to repurchase each membership unit then owned by the participant at fair value, as determined in good faith by the Board of Directors of TJ Chemical.

As of the effective date of the IPO, TJ Chemical transferred all benefits under the Option Plan and all outstanding grants of awards to Kraton Performance Polymers, Inc. In addition, any future awards payable in membership units of TJ Chemical will be adjusted to provide for a distribution of Kraton Performance Polymers, Inc. shares of equal value. The remaining terms of all outstanding awards remain substantially the same, including with respect to vesting and forfeiture provisions.

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Index to Financial Statements

**KRATON PERFORMANCE POLYMERS, INC.**

**Notes to Consolidated Financial Statements (Continued)**

Furthermore, effective as of the date of the IPO, the outstanding equity and equity awards of TJ Chemical held by the Named Executive Officers were cancelled and converted into equity or equity awards, as applicable, of Kraton Performance Polymers, Inc. Each membership unit was exchanged for a number of common shares of Kraton Performance Polymers, Inc. of equal value and each option was converted, in compliance with Section 409A of the Code, into an option to purchase a number of common shares equal in value to the number of membership units underlying the option at the date of the IPO, rounded down to the nearest whole share.

*(g) Polymer Holdings 2009 Equity Incentive Plan.* On November 30, 2009, the Kraton Performance Polymers, Inc. board of directors and our stockholders approved the Polymer Holdings LLC Equity Incentive Plan (the "Equity Plan"). The Equity Plan allows for the grant to key employees, independent contractors, and eligible non-employee directors of incentive stock options ("ISOs"), non-qualified stock options ("NSOs") and together with the ISOs, "Options"), stock appreciation rights ("SARs"), restricted stock awards and restricted stock unit awards, in addition to other equity or equity-based awards as the board determines is necessary from time to time. As of the IPO, there were 4,350,000 shares of common stock reserved for issuance under the Equity Plan. Shares of common stock issued under the Equity Plan may be either authorized and unissued shares or treasury shares, or both, at the sole discretion of the Committee. Subject to the terms of the Equity Plan, we reserved shares, which may be issued pursuant to incentive stock options ("ISOs"). Any shares covered by an award that are not purchased or are forfeited or otherwise terminated shall be available for future grants under the Equity Plan. Furthermore, no participant may receive awards under the Equity Plan in any calendar year that relate to more than 300,000 shares of common stock.

The Committee will determine which employees and independent contractors are eligible to receive awards under the Equity Plan. In addition, the Committee will interpret the Equity Plan and may adopt any administrative rules, regulations, procedures and guidelines governing the Equity Plan or any awards granted under the Equity Plan as it deems to be appropriate. The Board may grant awards to directors. On or after the date of grant of an award, the Committee may (i) in the event of the Participant's death, disability or retirement, or in the event of a change in control, accelerate the date on which any such award becomes vested or exercisable, as the case may be, (ii) accelerate the date on which any such award becomes transferable, (iii) extend the term of any such award, (iv) waive any conditions to the vesting, exercisability or transferability, as the case may be of such award or (v) provide for the payment of dividends or dividend equivalents with respect to any such award; provided such action would not cause tax to become due under Section 409A of the Code. The Equity Plan may be further amended or terminated by our board of directors at any time, but no amendment may be made without stockholder approval if it would require approval by stockholders in order to comply with any applicable law, regulation or the rules of the New York Stock Exchange.

The Committee may grant other stock-based awards to employees and independent contractors and our board of directors may grant such awards to directors subject to such terms and conditions as the Committee or our board of directors, as appropriate, may determine. Each such award may (i) involve the transfer of actual shares of our common stock to participants, either at the time of grant or thereafter, or payment in cash or otherwise of amounts based on the value of shares of our common stock, (ii) be subject to performance-based and/or service-based conditions, (iii) be in the form of phantom stock, restricted stock, restricted stock units, performance shares, deferred share units or share-denominated performance units, (iv) be designed to comply with applicable laws of jurisdictions other than the United States and (v) be designed to qualify as performance-based compensation.

The amount payable with respect to an award that is intended to qualify as performance-based compensation under the Equity Plan shall be determined in any manner permitted by Section 162(m) of the Code. The



**Index to Financial Statements**

**KRATON PERFORMANCE POLYMERS, INC.**

**Notes to Consolidated Financial Statements (Continued)**

Committee shall establish performance measures, the level of actual achievement of performance goals and the amount payable with respect to an award intended to qualify under Section 162(m) of the Code. The grant, exercise and/or settlement of such performance or annual incentive award shall be contingent upon achievement of pre-established performance goals which shall consist of one or more business criteria and a targeted level or levels of performance with respect to each of such criteria. Performance goals shall be objective and shall otherwise meet the requirements of Section 162(m) of the Code.

We awarded 74,008 shares of restricted stock to our executives on December 22, 2009, the date the IPO closed, as follows: Mr. Fogarty, 37,004; Mr. Bradley, 22,202; and Mr. Tremblay, 14,802.

**(h) Other Equity Awards.** We provided certain key employees with a grant of profits units of Kraton Management LLC (subject to the 8% pool limitation described above). Profits units are economically equivalent to an option, except that they provide the recipient/employee with an opportunity to recognize capital gains in the appreciation of TJ Chemical and its affiliates and TJ Chemical and its affiliates does not receive any deduction at the time of grant or disposition of the profits unit by the employee. Generally, pursuant to the applicable grant agreements, 50% of such profits units will vest when the fair value of TJ Chemical's assets equals or exceeds two times the Threshold Amount, i.e., the first tranche, and the remaining 50% will vest when the fair value of TJ Chemical's assets equals or exceeds three times the threshold amount, i.e., the second tranche, in each case, as determined by the Board of TJ Chemical, provided that the executive remains employed through the applicable vesting date. Additionally, 100% of the profits units shall vest upon the effective date of a disposition by the initial investors of 51% or more of their aggregate interests in Kraton. If at the time TJ Chemical makes a determination as to whether an individual is entitled to any appreciation with respect to the profits units, the value of the assets is more than two times, but less than three times the Threshold Amount, a pro rata portion of the second tranche will vest based on the appreciation above the two times Threshold Amount. Compensation expense will be recorded in our consolidated financial statements for this difference at the time it becomes probable the profits units will become vested. If an employee's employment terminates prior to any applicable vesting date, such employee shall automatically forfeit all rights to any unvested profits units. As of December 31, 2009 and 2008, there were 0 shares and 900,000 profits units granted and not yet vested, respectively.

In connection with the IPO, each award of profits units was converted into a number of shares of restricted shares equal to the quotient of (i) the product of the number of profits units multiplied by the Profits Unit Value (as defined below) divided by (ii) the value of a common share of our company immediately following the closing date of the offering. For these purposes, Profits Unit Value means, with respect to an award of profits units, the difference between the fair value of a membership unit immediately prior to the closing of the offering and \$1.00 (which represents the value of a membership unit on the date the profits unit award was granted).

**(i) 2009 Incentive Compensation Plan.** On February 13, 2009, the Compensation Committee of the Board of Directors of Kraton Performance Polymers, Inc. approved and adopted the 2009 Incentive Compensation Plan, including the performance-based criteria by which potential bonus payouts to participants will be determined.

The bonus pool was based largely on EBITDA performance and as a result of our actual performance against targeted levels of EBITDA there were no incentive compensation awards under this plan in 2009.

**8. Commitments and Contingencies**

**(a) Lease Commitments**

We have entered into various long-term non-cancelable operating leases. Future minimum lease commitments at December 31, 2009, are as follows: 2010 \$5.4 million; 2011 \$5.0 million; 2012 \$4.9

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**Index to Financial Statements**

**KRATON PERFORMANCE POLYMERS, INC.**

**Notes to Consolidated Financial Statements (Continued)**

million; 2013 \$2.5 million; 2014 \$2.3 million and thereafter \$13.1 million. We recorded \$4.1 million, \$8.4 million and \$8.5 million in rent expense for the years ended December 31, 2009, 2008 and 2007, respectively.

***(b) Environmental and Safety Matters***

Our finished products are not classified as hazardous. However, our operations involve the handling, transportation, treatment, and disposal of potentially hazardous materials that are extensively regulated by environmental, health and safety laws, regulations and permit requirements. Environmental permits required for our operations are subject to periodic renewal and can be revoked or modified for cause or when new or revised environmental requirements are implemented. Changing and increasingly strict environmental requirements can affect the manufacturing, handling, processing, distribution and use of our chemical products and the raw materials used to produce such products and, if so affected, our business and operations may be materially and adversely affected. In addition, changes in environmental requirements can cause us to incur substantial costs in upgrading or redesigning our facilities and processes, including waste treatment, disposal, and other waste handling practices and equipment.

We conduct environmental management programs designed to maintain compliance with applicable environmental requirements at all of our facilities. We routinely conduct inspection and surveillance programs designed to detect and respond to leaks or spills of regulated hazardous substances and to correct identified regulatory deficiencies. We believe that our procedures for waste handling are consistent with industry standards and applicable requirements. In addition, we believe that our operations are consistent with good industry practice. However, a business risk inherent with chemical operations is the potential for personal injury and property damage claims from employees, contractors and their employees, and nearby landowners and occupants. While we believe our business operations and facilities generally are operated in compliance, in all material respects, with all applicable environmental and health and safety requirements, we cannot be sure that past practices or future operations will not result in material claims or regulatory action, require material environmental expenditures, or result in exposure or injury claims by employees, contractors and their employees, and the public. Some risk of environmental costs and liabilities are inherent in our operations and products, as it is with other companies engaged in similar businesses.

The Paulinia, Brazil and Belpre, Ohio facilities are subject to a number of actual and/or potential environmental liabilities primarily relating to contamination caused by former operations at those facilities. Some environmental laws could impose on us the entire costs of cleanup regardless of fault, legality of the original disposal, or ownership of the disposal site. In some cases, the governmental entity with jurisdiction could seek an assessment for damage to the natural resources caused by contamination from those sites. Shell Chemicals has agreed, subject to certain limitations, in time and amounts, to indemnify us against most environmental liabilities related to the acquired facilities that arise from conditions existing prior to the closing.

We had no material operating expenditures for environmental fines, penalties, government imposed remedial or corrective actions in each of the years ended December 31, 2009, 2008 and 2007.

***(c) Legal Proceedings***

We and certain of our subsidiaries are parties to several legal proceedings that have arisen in the ordinary course of business. While the outcome of these proceedings cannot be predicted with certainty, management does not expect these matters, individually or in the aggregate, to have a material adverse effect upon our financial position, results of operations or cash flows. Furthermore, Shell Chemicals has agreed, subject to certain limitations, to indemnify us for certain claims brought with respect to matters occurring before February 28, 2001.

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**Index to Financial Statements**

**KRATON PERFORMANCE POLYMERS, INC.**

**Notes to Consolidated Financial Statements (Continued)**

**9. Fair Value Measurements**

Effective January 1, 2008, we adopted ASC 820, Fair Value Measurements and Disclosures. ASC 820 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 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.

Level 3 Model-derived valuations in which one or more significant inputs or significant value drivers are unobservable. From time to time, we enter into derivative financial instruments that are measured at fair value. See Note 15 for further discussion.

**10. Significant Contracts**

We are party to significant contracts with subsidiaries and affiliates of Shell Chemicals and LyondellBasell. These contracts are for: (1) leases of land and facilities at some of our foreign locations; (2) operating agreements where LyondellBasell operates some of our foreign manufacturing facilities; (3) site services, utilities, material and facilities agreements at some of our foreign manufacturing facilities; (4) raw material supply agreements; and (5) transitional and interim service agreements.

*(a) Leases with Shell Chemicals and LyondellBasell.* The land on which our manufacturing facility in Berre, France is located was leased to us by Shell Petrochimie Mediterranee (SPM) through April 1, 2008, at which time the site was sold to LyondellBasell, who now operates the site and with whom our tenancy now exists under a long-term lease due to expire in 2030. Our Wesseling, Germany manufacturing facility is located on an industrial site belonging to LyondellBasell. LyondellBasell owns the land and buildings at our Wesseling facility and leases same to us. The lease is for a term of 30 years, beginning from March 31, 2000 and is extended automatically for a successive period of 10 years unless terminated upon one-year prior written notice by either party. These lease agreements, including the financial terms thereof, have all been negotiated at arm's length.

*(b) Operating Agreements.* LyondellBasell operates our manufacturing facility located in Berre, France. This facility is situated on a major LyondellBasell refinery and petrochemical site at which other third party tenants also own facilities and lease space. LyondellBasell charges us fees based on certain costs incurred in connection with operating and maintaining this facility, including the direct and indirect costs of employees and subcontractors, reasonable insurance costs, certain taxes imposed on LyondellBasell (other than income taxes)



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**Index to Financial Statements**

**KRATON PERFORMANCE POLYMERS, INC.**

**Notes to Consolidated Financial Statements (Continued)**

and depreciation and capital charges on certain assets. Pursuant to the applicable operating agreement, LyondellBasell employs and provides all staff, other than certain plant managers, assistant plant managers and technical personnel whom we may appoint. The agreement has an initial term of 20 years, and thereafter will automatically renew indefinitely for consecutive 5-year periods. Either party may terminate the agreement (totally or partially) under various circumstances, including if the terminating party ceases its operations at the facility and provides 18 (eighteen) months prior written notice; or if any of the services, utilities, materials and facilities agreements have been terminated, and the terminating party provides notice as required by such agreement.

Pursuant to an agreement dated March 31, 2000, LyondellBasell operates and provides certain services, materials and utilities required to operate our manufacturing facility in Wesseling, Germany. We pay LyondellBasell a monthly fee, as well as costs incurred by LyondellBasell in providing the various services, even if the facility fails to produce any output (whether or not due to events within LyondellBasell's control), and even if we reject some or all output. This agreement has an initial term of 40 years and will automatically renew, subject to 5 (five) years prior written notice of non-renewal. This agreement will terminate at any earlier date as of which the facility can no longer be operated in a safe and efficient manner. These operating agreements, including the financial terms thereof, have all been negotiated at arm's length.

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

**(d) Raw Materials Agreements.** Styrene, butadiene and isoprene used by our U.S. facilities are primarily supplied by a portfolio of suppliers under long-term supply contracts with various expiration dates. The monomers used by our European facilities are primarily supplied by one or more LyondellBasell entities or affiliates, and other suppliers under long-term supply contracts with various expiration dates. For our U.S. facilities, we also procure a substantial amount of isoprene from a variety of suppliers from Russia, China and Japan. These purchases include both spot and contract arrangements. We generally contract with them on a short-term basis, although the number of such contracts has been increasing since 2008.

We believe our contractual arrangements with our suppliers of styrene, butadiene and isoprene provide an adequate supply of raw materials at competitive, market-based prices.

Under each of the agreements summarized below, reasonably unforeseen circumstances, including, without limitations, plant breakdowns, will excuse performance by either party. In addition, inability to acquire any supplies or components necessary for manufacturing the applicable raw material from usual sources and on terms the supplier deems reasonable will excuse supplier's nonperformance.

**Styrene.** We satisfy our styrene requirements in the United States pursuant to purchase agreements that run through 2011 subject to renewal conditions.

Our contracts that satisfied our styrene requirements in Europe expired on February 28, 2010 and we have finalized negotiations with two vendors and expect to execute new supply agreements that we anticipate will provide for European Styrene supply through to February 2013. As contracts expire, we cannot give assurances that we will obtain new long-term supply agreements, or that the terms of any such agreements will be on terms favorable to us, and as a consequence, our future acquisition costs for styrene may therefore increase.

**Index to Financial Statements****KRATON PERFORMANCE POLYMERS, INC.****Notes to Consolidated Financial Statements (Continued)**

For our agreements covering our manufacturing facility in the United States, the price we pay for styrene varies with the published prices of styrene and/or the raw materials used to produce styrene. The price we pay for styrene under our agreements covering France and Germany varies to reflect the published price for styrene, even though our purchase price is subject to certain minimums and maximums that vary with other factors.

**Butadiene.** We currently source butadiene in the United States pursuant to contract arrangements with several suppliers, supplemented by spot supply as needed. The price we pay for butadiene is scheduled and varies based on the published prices for butadiene in world markets.

We currently source our butadiene in Europe pursuant to contracts with certain LyondellBasell entities. The contract covering Germany will expire on December 31, 2040, and will be renewed automatically at the conclusion of the current term unless terminated with prior written notice by either party. The contract covering France expired pursuant to its terms on December 31, 2007; provided, however, that on December 12, 2006, we were notified by LyondellBasell of its intention to allow the contract to automatically renew for one year, and to terminate effective December 31, 2008. We are presently acquiring butadiene from an LyondellBasell entity in France under a commercial term sheet, reflecting an agreement in principle that has been reached between the parties. The price we pay for butadiene under our arrangements or agreements covering France and Germany vary based upon the published price for butadiene, the amount of butadiene purchased during the preceding calendar year, and/or the cost of butadiene manufactured. In Brazil, butadiene is obtained from a local third-party source. In Kashima, Japan, a majority of our butadiene needs are sourced from JSR Corporation ( JSR ), on a commercial supply basis.

**Isoprene.** We source our global isoprene requirements through several contract arrangements. We also purchase some additional supplies of isoprene from various suppliers at prevailing market prices. In Brazil, isoprene is obtained from a local third party supplier. In Kashima, Japan, the majority of our isoprene needs are sourced from JSR on a commercial supply basis and from alternative suppliers as needed.

**(e) Infineum**

We have entered into several commercial agreements with Infineum, a joint venture between Shell Chemicals and ExxonMobil, related to: (1) the sharing by Infineum of certain production capacity at our Belpre, Ohio manufacturing facility; and (2) our production of certain additives for Infineum at our Belpre, Ohio and our Berre, France manufacturing facilities. The Belpre, Ohio agreements have a 30-year term, and the Berre, France agreement has a term ending in December 2010.

**11. Related Party Transactions**

We own a 50% equity investment in a manufacturing joint venture with JSR Corporation ( JSR ) under the name of Kraton JSR Elastomers K.K. ( KJE ) located in Kashima, Japan. KJE manufactures thermoplastic rubber ( TR ), which is a wholly or predominantly composed of a block co-polymer comprising styrene blocks with butadiene and/or isoprene polymer blocks. KJE produces TR for sale to third party customers only through Kraton and JSR. We and JSR separately, but with equal rights, participate as distributors in the sales of the TR produced by KJE.

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

|                              | 2009      | December 31,<br>2008 | 2007      |
|------------------------------|-----------|----------------------|-----------|
| Sales to related party       | \$        | \$ 626               | \$ 1,210  |
| Purchases from related party | \$ 27,763 | \$ 37,894            | \$ 39,741 |

Index to Financial Statements**KRATON PERFORMANCE POLYMERS, INC.****Notes to Consolidated Financial Statements (Continued)**

A private investment fund managed by TPG Capital L.P., which advises TPG Partners III and TPG Partners IV, has an ownership share of British Vita PLC, one of our customers. From 2007 to 2009 we have derived revenues averaging \$9.2 million annually from sales to British Vita. We do not have any contractual requirements for sales to British Vita.

In October 2009, we entered into a contract with Amyris Biotechnologies, Inc. to explore the development of an alternative source of certain raw materials and, subject to Amyris meeting developmental and manufacturing milestones, to purchase raw materials from Amyris. We have not made any purchases to date. TPG Biotechnology II, L.P., a private investment fund that may be deemed to be an affiliate of TPG III and TPG IV, has an ownership share of Amyris Biotechnologies.

**12. Earnings per Common Share**

*Common stock* Kraton Performance Polymers, Inc. has authorized 500.0 million shares of common stock with a par value of \$0.01 per share and 100.0 million shares of preferred stock with a par value of \$0.01 per share. No preferred stock has been issued.

As of December 31, 2009, there were 29,709,114 common shares issued and outstanding. We held no treasury shares.

*Earnings per share* Basic earnings per common share ( EPS ) is computed by dividing net income by the weighted-average number of common shares outstanding during the period. The weighted average number of common shares used in the diluted earnings per share calculation is determined using the treasury stock method. Diluted EPS is computed by dividing net income by the diluted weighted-average number of common shares outstanding during the period. Diluted EPS reflects the potential dilution that could occur if securities or other agreements to issue common stock, such as stock options, stock-based performance awards and preferred stock, were exercised, settled or converted into common stock.

The following table summarizes the effect of the share-based compensation awards on the weighted- average number of shares outstanding used in calculating diluted earnings per share:

|   | December 31,                          |           |             |
|---|---------------------------------------|-----------|-------------|
|   | 2009                                  | 2008      | 2007        |
|   | (In thousands, except per share data) |           |             |
| Net income (loss) as reported   | \$ (290)                              | \$ 28,419 | \$ (43,749) |
| Weighted-average number of common shares for basic earnings per share | 19,844                                | 19,406    | 19,375      |
| Incremental effect of dilutive common stock equivalents:              |                                       |           |             |
| Restricted and notional units   |                                       | 77        |             |
| Weighted-average number of shares for diluted earnings per share      | 19,844                                | 19,483    | 19,375      |
| Earnings (loss) per common share basic                                | \$ (0.01)                             | \$ 1.46   | \$ (2.26)   |
| Earnings (loss) per common share dilutive                             | \$ (0.01)                             | \$ 1.46   | \$ (2.26)   |

Restricted and Notional units of 78 and 118 thousand units at December 31, 2009 and 2007, respectively, were not included in the computation of diluted earnings per share because we incurred net losses in those years. Stock option awards of 1,585, 1,636 and 1,086 thousand shares, respectively, were outstanding at December 31, 2009, 2008 and 2007, respectively, and were not included in the computation of diluted earnings per common share because these options were antidilutive.

**Index to Financial Statements****KRATON PERFORMANCE POLYMERS, INC.****Notes to Consolidated Financial Statements (Continued)****13. Industry Segment and Foreign Operations**

We operate in one segment for the manufacture and marketing of styrenic block copolymers. 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 consolidated financial statements.

For geographic reporting, revenues are 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. Total operating revenues and long-lived assets by geographic region were as follows:

|                                  | 2009       | December 31,<br>2008<br>(in thousands) | 2007         |
|----------------------------------|------------|--|--------------|
| <b>Total Operating Revenues:</b> |            |  |              |
| United States                    | \$ 304,265 | \$ 395,568                             | \$ 366,048   |
| Germany                          | 121,959    | 149,011                                | 145,649      |
| Japan                            | 73,055     | 70,169                                 | 53,479       |
| The Netherlands                  | 66,027     | 80,980                                 | 49,334       |
| Brazil                           | 40,438     | 40,868                                 | 36,732       |
| China                            | 37,123     | 31,421                                 | 33,956       |
| Italy                            | 35,934     | 48,328                                 | 51,569       |
| Thailand                         | 28,779     | 22,877                                 | 14,916       |
| United Kingdom                   | 27,425     | 40,401                                 | 38,364       |
| France                           | 27,342     | 39,757                                 | 30,358       |
| Belgium                          | 16,273     | 30,079                                 | 30,751       |
| Canada                           | 16,168     | 25,361                                 | 22,300       |
| Taiwan                           | 15,711     | 18,527                                 | 20,196       |
| Poland                           | 15,537     | 26,934                                 | 22,604       |
| Turkey                           | 12,990     | 15,979                                 | 14,432       |
| Sweden                           | 11,292     | 13,002                                 | 12,418       |
| Mexico                           | 11,029     | 14,028                                 | 9,460        |
| Argentina                        | 10,854     | 17,174                                 | 14,109       |
| Republic of Korea                | 9,928      | 11,013                                 | 8,877        |
| Australia                        | 9,124      | 15,939                                 | 8,856        |
| Denmark                          | 8,283      | 9,147                                  | 8,795        |
| Austria                          | 8,170      | 13,062                                 | 9,973        |
| Malaysia                         | 6,769      | 4,396                                  | 3,631        |
| Switzerland                      | 4,994      | 5,348                                  | 4,914        |
| India                            | 4,148      | 4,312                                  | 2,001        |
| Czech Republic                   | 4,024      | 4,273                                  | 4,021        |
| Hong Kong                        | 4,000      | 7,430                                  | 8,369        |
| All other countries              | 36,363     | 70,649                                 | 63,475       |
|                                  | \$ 968,004 | \$ 1,226,033                           | \$ 1,089,587 |





**Index to Financial Statements****KRATON PERFORMANCE POLYMERS, INC.****Notes to Consolidated Financial Statements (Continued)**

During the years ended December 31, 2009, 2008 and 2007, no single customer accounted for 10% or more of our total operating revenues.

|                           | 2009       | December 31,<br>2008<br>(in thousands) | 2007       |
|---------------------------|------------|--|------------|
| <b>Long-lived Assets:</b> |            |  |            |
| United States             | \$ 317,719 | \$ 303,278                             | \$ 298,979 |
| Germany                   | 42,724     | 39,361                                 | 40,406     |
| Japan                     | 482        | 6,699                                  | 3,743      |
| France                    | 125,839    | 108,665                                | 111,441    |
| The Netherlands           | 36,971     | 34,018                                 | 34,454     |
| Brazil                    | 64,385     | 48,237                                 | 56,721     |
| China                     | 2,334      | 2,317                                  | 2,119      |
| All other countries       | 964        | 11,685                                 | 12,050     |
|                           | \$ 591,418 | \$ 554,260                             | \$ 559,913 |

**14. Supplemental Guarantor Information**

Kraton and Kraton Polymers Capital Corporation, a financing subsidiary, collectively, the Issuers, are co-issuers of the 8.125% Notes. The Guarantor Subsidiaries include Elastomers Holdings LLC, a U.S. holding company, and Kraton Polymers U.S. LLC, a U.S. operating subsidiary, collectively, the Guarantor Subsidiaries, fully and unconditionally guarantee on a joint and several basis, the Issuers' obligations under the 8.125% Notes. Our remaining subsidiaries are not guarantors of the 8.125% 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.

**Correction of immaterial errors.** During 2009, we identified errors associated with the classification of certain cash inflows and outflows as disclosed within the condensed consolidating financial information of the issuer, guarantor and non-guarantor subsidiaries for the years ended December 31, 2008 and 2007. The errors were primarily due to the fact that cash outflows associated with disbursements for certain intercompany loans and receipts from collections on these loans were classified within cash flows from financing activities rather than investing activities. Consequently, we have corrected immaterial errors in the accompanying condensed consolidated Statements of Cash Flows for the year ended December 31, 2008 by increasing issuer cash flows used in investing activities by \$38.1 million and increasing issuer cash flows provided by financing activities by the same amount, and for the year ended December 31, 2007 by (i) increasing issuer cash flows provided by investing activities by \$69 million and increasing issuer cash flows used in financing activities by the same amount, (ii) reducing guarantor subsidiaries' cash flows from operating activities by \$7.2 million and reducing guarantor subsidiaries' cash flows used in financing activities by the same amount, and (iii) increasing non-guarantor subsidiaries' cash flows from operating activities by \$7.2 million and increasing non-guarantor subsidiaries' cash flows used in financing activities by the same amount. The correction of these errors does not impact the net change in cash and cash equivalents, has no impact on net income and is not material to our previously reported Consolidating Statements of Cash Flows.

**Index to Financial Statements****KRATON PERFORMANCE POLYMERS, INC.****CONSOLIDATING BALANCE SHEET****December 31, 2009****(In thousands, except par value)**

|   | <b>Kraton<br/>Performance<br/>Polymers(1)</b> | <b>Kraton(2)</b>    | <b>Guarantor<br/>Subsidiaries</b> | <b>Non-Guarantor<br/>Subsidiaries</b> | <b>Eliminations</b>   | <b>Consolidated</b> |
|---|---|---------------------|-----------------------------------|---------------------------------------|-----------------------|---------------------|
| <b>ASSETS</b>   |   |                     |                                   |                                       |                       |                     |
| <b>Current Assets</b>   |   |                     |                                   |                                       |                       |                     |
| Cash and cash equivalents   | \$  | \$                  | \$ 36,567                         | \$ 32,724                             | \$                    | \$ 69,291           |
| Receivables, net of allowance   |   |                     | 41,194                            | 74,135                                |                       | 115,329             |
| Inventories of products, net  |   |                     | 124,003                           | 160,255                               |                       | 284,258             |
| Inventories of materials and supplies, net  |   |                     | 6,830                             | 4,032                                 |                       | 10,862              |
| Deferred income taxes   |   |                     |                                   | 3,107                                 |                       | 3,107               |
| Other current assets  |   | 1,086               | 1,421                             | 14,263                                |                       | 16,770              |
| <b>Total current assets</b>   |   | <b>1,086</b>        | <b>210,015</b>                    | <b>288,516</b>                        |                       | <b>499,617</b>      |
| Property, plant and equipment, less accumulated depreciation                                    |   | 85,284              | 171,024                           | 98,552                                |                       | 354,860             |
| Identifiable intangible assets, less accumulated amortization                                   |   | 13,541              | 15,322                            | 46,938                                |                       | 75,801              |
| Investment in consolidated subsidiaries   | 312,164                                       | 971,995             |                                   |                                       | (1,284,159)           |                     |
| Investment in unconsolidated joint venture  |   | 813                 |                                   | 11,265                                |                       | 12,078              |
| Deferred financing costs  |   | 7,309               |                                   | 9                                     |                       | 7,318               |
| Deferred income taxes   | 34  |                     |                                   |                                       | (34)                  |                     |
| Other long-term assets  |   | 1,142               | 468,794                           | 95,054                                | (540,165)             | 24,825              |
| <b>Total Assets</b>   | <b>\$ 312,198</b>                             | <b>\$ 1,081,170</b> | <b>\$ 865,155</b>                 | <b>\$ 540,334</b>                     | <b>\$ (1,824,358)</b> | <b>\$ 974,499</b>   |
| <b>LIABILITIES AND STOCKHOLDERS AND MEMBER S EQUITY</b>   |   |                     |                                   |                                       |                       |                     |
| <b>Current Liabilities</b>  |   |                     |                                   |                                       |                       |                     |
| Current portion of long-term debt   | \$  | \$ 2,304            | \$                                | \$                                    | \$                    | \$ 2,304            |
| Accounts payable-trade  |   | 2,699               | 37,732                            | 53,063                                |                       | 93,494              |
| Other payables and accruals   |   | 18,251              | 15,010                            | 35,118                                | (108)                 | 68,271              |
| Due to related party  |   |                     |                                   | 19,006                                |                       | 19,006              |
| <b>Total current liabilities</b>  |   | <b>23,254</b>       | <b>52,742</b>                     | <b>107,187</b>                        | <b>(108)</b>          | <b>183,075</b>      |
| Long-term debt, net of current portion  | 250   | 382,425             |                                   |                                       |                       | 382,675             |
| Deferred income taxes   |   | 12,858              |                                   | 630                                   |                       | 13,488              |
| Long-term liabilities   |   | 351,353             | 47,494                            | 187,721                               | (540,091)             | 46,477              |
| <b>Total liabilities</b>  | <b>250</b>                                    | <b>769,890</b>      | <b>100,236</b>                    | <b>295,538</b>                        | <b>(540,199)</b>      | <b>625,715</b>      |
| <b>Commitments and contingencies (note 8)</b>   |   |                     |                                   |                                       |                       |                     |
| <b>Stockholders and Member s equity</b>   |   |                     |                                   |                                       |                       |                     |
| Preferred stock, \$0.01 par value; 100,000 shares authorized; none issued                       |   |                     |                                   |                                       |                       |                     |
| Common stock, \$0.01 par value; 500,000 shares authorized; 29,709 shares issued and outstanding | 297   |                     |                                   |                                       |                       | 297                 |
| Additional paid in capital  | 311,665                                       |                     |                                   |                                       |                       | 311,665             |

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|  |      |                   |                     |                   |                   |                       |                   |
|--|------|-------------------|---------------------|-------------------|-------------------|-----------------------|-------------------|
| Member s equity  |      | 312,164           | 775,493             | 196,502           | (1,284,159)       |                       |                   |
| Retained Earnings  | (14) |                   |                     |                   |                   | (14)                  |                   |
| Accumulated other comprehensive income                         |      | (884)             | (10,574)            | 48,294            |                   | 36,836                |                   |
| <b>Total stockholders and member s equity</b>                  |      | <b>311,948</b>    | <b>311,280</b>      | <b>764,919</b>    | <b>244,796</b>    | <b>(1,284,159)</b>    | <b>348,784</b>    |
| <b>Total Liabilities and Stockholders and Member s Equity.</b> |      | <b>\$ 312,198</b> | <b>\$ 1,081,170</b> | <b>\$ 865,155</b> | <b>\$ 540,334</b> | <b>\$ (1,824,358)</b> | <b>\$ 974,499</b> |

- (1) Kraton Performance Polymers and Polymer Holdings Capital Corporation are the issuers of the 12% Discount Notes. Polymer Holdings Capital Corporation has minimal assets and income. We do not believe that separate financial information concerning the issuers would provide information that would be useful.
- (2) Kraton and Kraton Polymers Capital Corporation are the issuers of the 8.125% Notes. 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 useful.

F-45

Index to Financial Statements**KRATON PERFORMANCE POLYMERS, INC.****CONSOLIDATING BALANCE SHEET**

December 31, 2008

(In thousands)

|   | Kraton                     |                     | Guarantor         | Non-Guarantor     | Eliminations          | Consolidated        |
|---|----------------------------|---------------------|-------------------|-------------------|-----------------------|---------------------|
|   | Performance<br>Polymers(1) | Kraton(2)           | Subsidiaries      | Subsidiaries      |                       |                     |
| <b>ASSETS</b>   |                            |                     |                   |                   |                       |                     |
| <b>Current Assets</b>   |                            |                     |                   |                   |                       |                     |
| Cash and cash equivalents                                     | \$                         | \$                  | \$ 65,460         | \$ 35,936         | \$                    | \$ 101,396          |
| Receivables, net of allowance                                 |                            | 944                 | 45,322            | 68,148            | (18,971)              | 95,443              |
| Inventories of products, net                                  |                            |                     | 145,654           | 187,396           | (8,857)               | 324,193             |
| Inventories of materials and supplies, net                    |                            |                     | 6,816             | 4,239             |                       | 11,055              |
| Deferred income taxes   |                            |                     | 14,778            |                   |                       | 14,778              |
| Other current assets  |                            | 2,905               | 720               | 3,144             |                       | 6,769               |
| <b>Total current assets</b>                                   |                            | <b>3,849</b>        | <b>278,750</b>    | <b>298,863</b>    | <b>(27,828)</b>       | <b>553,634</b>      |
| Property, plant and equipment, less accumulated depreciation  |                            | 93,782              | 164,396           | 113,830           |                       | 372,008             |
| Identifiable intangible assets, less accumulated amortization |                            | 20,113              |                   | 46,938            |                       | 67,051              |
| Investment in consolidated subsidiaries                       | 182,767                    | 898,565             |                   |                   | (1,081,332)           |                     |
| Investment in unconsolidated joint venture                    |                            | 813                 |                   | 11,558            |                       | 12,371              |
| Deferred financing costs                                      |                            | 8,184               |                   |                   |                       | 8,184               |
| Deferred income taxes   | 31                         | 20,131              |                   |                   | (20,162)              |                     |
| Other long-term assets  |                            | 137,954             | 411,841           | 11,739            | (542,908)             | 18,626              |
| <b>Total Assets</b>   | <b>\$ 182,798</b>          | <b>\$ 1,183,391</b> | <b>\$ 854,987</b> | <b>\$ 482,928</b> | <b>\$ (1,672,230)</b> | <b>\$ 1,031,874</b> |
| <b>LIABILITIES AND MEMBER S EQUITY</b>                        |                            |                     |                   |                   |                       |                     |
| <b>Current Liabilities</b>                                    |                            |                     |                   |                   |                       |                     |
| Current portion of long-term debt                             | \$                         | \$ 3,343            | \$                | \$                | \$                    | \$ 3,343            |
| Accounts payable-trade  |                            | 2,700               | 36,806            | 35,671            |                       | 75,177              |
| Other payables and accruals                                   |                            | 15,815              | 26,184            | 27,350            |                       | 69,349              |
| Due to related party  |                            |                     | 9,546             | 35,010            | (18,971)              | 25,585              |
| <b>Total current liabilities</b>                              |                            | <b>21,858</b>       | <b>72,536</b>     | <b>98,031</b>     | <b>(18,971)</b>       | <b>173,454</b>      |
| Long-term debt, net of current portion                        | 245                        | 571,728             |                   |                   |                       | 571,973             |
| Deferred income taxes   |                            |                     | 53,435            | 1,681             | (20,162)              | 34,954              |
| Long-term liabilities   |                            | 408,416             | 53,626            | 143,983           | (542,908)             | 63,117              |
| <b>Total liabilities</b>                                      | <b>245</b>                 | <b>1,002,002</b>    | <b>179,597</b>    | <b>243,695</b>    | <b>(582,041)</b>      | <b>843,498</b>      |
| <b>Commitments and contingencies (note 8) Member s equity</b> |                            |                     |                   |                   |                       |                     |
| Member s equity   | 182,553                    | 182,767             | 694,170           | 213,252           | (1,090,189)           | 182,553             |
| Accumulated other comprehensive income                        |                            | (1,378)             | (18,780)          | 25,981            |                       | 5,823               |
| <b>Total member s equity</b>                                  | <b>182,553</b>             | <b>181,389</b>      | <b>675,390</b>    | <b>239,233</b>    | <b>(1,090,189)</b>    | <b>188,376</b>      |
| <b>Total Liabilities and Member s Equity.</b>                 | <b>\$ 182,798</b>          | <b>\$ 1,183,391</b> | <b>\$ 854,987</b> | <b>\$ 482,928</b> | <b>\$ (1,672,230)</b> | <b>\$ 1,031,874</b> |

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- (1) Kraton Performance Polymers and Polymer Holdings Capital Corporation are the issuers of the 12% Discount Notes. Polymer Holdings Capital Corporation has minimal assets and income. We do not believe that separate financial information concerning the issuers would provide information that would be useful.
- (2) Kraton and Kraton Polymers Capital Corporation are the issuers of the 8.125% Notes. 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 useful.

F-46

Index to Financial Statements

## KRATON PERFORMANCE POLYMERS, INC.

## CONSOLIDATING STATEMENT OF OPERATIONS

Year Ended December 31, 2009

(In thousands)

|   | Kraton      |           | Guarantor    | Non-Guarantor | Eliminations | Consolidated |
|---|-------------|-----------|--------------|---------------|--------------|--------------|
|   | Performance | Kraton(2) | Subsidiaries | Subsidiaries  |              |              |
|   | Polymers(1) |           |              |               |              |              |
| <b>Operating Revenues</b>                                 |             |           |              |               |              |              |
| Sales   | \$          | \$        | \$ 480,438   | \$ 591,309    | \$ (151,385) | \$ 920,362   |
| Other   |             |           | 74           | 47,568        |              | 47,642       |
| Total operating revenues                                  |             |           | 480,512      | 638,877       | (151,385)    | 968,004      |
| <b>Cost of Goods Sold</b>                                 |             | (15,654)  | 376,543      | 582,968       | (151,385)    | 792,472      |
| <b>Gross Profit</b>                                       |             | 15,654    | 103,969      | 55,909        |              | 175,532      |
| <b>Operating Expenses</b>                                 |             |           |              |               |              |              |
| Research and development expenses                         |             |           | 13,150       | 8,062         |              | 21,212       |
| Selling, general and administrative expenses              |             | (1,430)   | 45,497       | 35,437        |              | 79,504       |
| Depreciation  |             | 22,039    | 21,598       | 23,114        |              | 66,751       |
| Total operating expenses                                  |             | 20,609    | 80,245       | 66,613        |              | 167,467      |
| <b>Gain on Extinguishment of Debt</b>                     |             | 23,831    |              |               |              | 23,831       |
| <b>Earnings in consolidated subsidiaries</b>              | (288)       | 29,893    |              |               | (29,605)     |              |
| <b>Equity in Earnings of Unconsolidated Joint Venture</b> |             |           |              | 403           |              | 403          |
| <b>Interest Expense (Income), net</b>                     | 5           | 40,818    | (11,156)     | 4,289         |              | 33,956       |
| <b>Income (Loss) Before Income Taxes</b>                  | (293)       | 7,951     | 34,880       | (14,590)      | (29,605)     | (1,657)      |
| <b>Income Tax Expense (Benefit)</b>                       | (3)         | 8,239     | (876)        | (8,727)       |              | (1,367)      |
| <b>Net Income (Loss)</b>                                  | \$ (290)    | \$ (288)  | \$ 35,756    | \$ (5,863)    | \$ (29,605)  | \$ (290)     |

- (1) Kraton Performance Polymers and Polymer Holdings Capital Corporation are the issuers of the 12% Discount Notes. Polymer Holdings Capital Corporation has minimal assets and income. We do not believe that separate financial information concerning the issuers would provide information that would be useful.
- (2) Kraton and Kraton Polymers Capital Corporation are the issuers of the 8.125% Notes. 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 useful.

Index to Financial Statements

## KRATON PERFORMANCE POLYMERS, INC.

## CONSOLIDATING STATEMENT OF OPERATIONS

Year Ended December 31, 2008

(In thousands)

|   | Kraton<br>Performance<br>Polymers(1) | Kraton(2) | Guarantor<br>Subsidiaries | Non-Guarantor<br>Subsidiaries | Eliminations | Consolidated |
|---|--------------------------------------|-----------|---------------------------|-------------------------------|--------------|--------------|
| <b>Operating Revenues</b>                                 |                                      |           |                           |                               |              |              |
| Sales   | \$                                   | \$        | \$ 607,428                | \$ 750,165                    | \$ (186,340) | \$ 1,171,253 |
| Other   |                                      |           |                           | 54,780                        |              | 54,780       |
| Total operating revenues                                  |                                      |           | 607,428                   | 804,945                       | (186,340)    | 1,226,033    |
| <b>Cost of Goods Sold</b>                                 |                                      | 2,356     | 467,079                   | 688,188                       | (186,340)    | 971,283      |
| <b>Gross Profit</b>                                       |                                      | (2,356)   | 140,349                   | 116,757                       |              | 254,750      |
| <b>Operating Expenses</b>                                 |                                      |           |                           |                               |              |              |
| Research and development expenses                         |                                      |           | 15,829                    | 11,220                        |              | 27,049       |
| Selling, general and administrative expenses              |                                      | 902       | 52,729                    | 47,800                        |              | 101,431      |
| Depreciation  |                                      | 18,127    | 21,676                    | 13,359                        |              | 53,162       |
| Total operating expenses                                  |                                      | 19,029    | 90,234                    | 72,379                        |              | 181,642      |
| <b>Earnings in consolidated subsidiaries</b>              | 28,434                               | 85,848    |                           |                               | (114,282)    |              |
| <b>Equity in Earnings of Unconsolidated Joint Venture</b> |                                      |           |                           | 437                           |              | 437          |
| <b>Interest Expense (Income), net</b>                     | 24                                   | 39,394    | (10,576)                  | 7,853                         |              | 36,695       |
| <b>Income (Loss) Before Income Taxes</b>                  | 28,410                               | 25,069    | 60,691                    | 36,962                        | (114,282)    | 36,850       |
| <b>Income Tax Expense (Benefit)</b>                       | (9)                                  | (3,365)   | 220                       | 11,585                        |              | 8,431        |
| <b>Net Income (Loss)</b>                                  | \$ 28,419                            | \$ 28,434 | \$ 60,471                 | \$ 25,377                     | \$ (114,282) | \$ 28,419    |

- (1) Kraton Performance Polymers and Polymer Holdings Capital Corporation are the issuers of the 12% Discount Notes. Polymer Holdings Capital Corporation has minimal assets and income. We do not believe that separate financial information concerning the issuers would provide information that would be useful.
- (2) Kraton and Kraton Polymers Capital Corporation are the issuers of the 8.125% Notes. 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 useful.



Index to Financial Statements

**KRATON PERFORMANCE POLYMERS, INC.**  
**CONSOLIDATING STATEMENT OF OPERATIONS**

Year Ended December 31, 2007

(In thousands)

|   | Kraton<br>Performance<br>Polymers(1) | Kraton(2)   | Guarantor<br>Subsidiaries | Non-Guarantor<br>Subsidiaries | Eliminations | Consolidated |
|---|--------------------------------------|-------------|---------------------------|-------------------------------|--------------|--------------|
| <b>Operating Revenues</b>                                 |                                      |             |                           |                               |              |              |
| Sales   | \$                                   | \$          | \$ 545,203                | \$ 669,809                    | \$ (148,968) | \$ 1,066,044 |
| Other   |                                      |             |                           | 23,543                        |              | 23,543       |
| Total operating revenues                                  |                                      |             | 545,203                   | 693,352                       | (148,968)    | 1,089,587    |
| <b>Cost of Goods Sold</b>                                 |                                      |             |                           |                               |              |              |
|   |                                      | 2,728       | 458,148                   | 626,648                       | (148,968)    | 938,556      |
| <b>Gross Profit</b>                                       |                                      |             |                           |                               |              |              |
|   |                                      | (2,728)     | 87,055                    | 66,704                        |              | 151,031      |
| <b>Operating Expenses</b>                                 |                                      |             |                           |                               |              |              |
| Research and development expenses                         |                                      |             | 7,851                     | 17,014                        |              | 24,865       |
| Selling, general and administrative expenses              |                                      | (193)       | 39,612                    | 29,601                        |              | 69,020       |
| Depreciation  |                                      | 19,687      | 20,299                    | 11,931                        |              | 51,917       |
| Total operating expenses                                  |                                      | 19,494      | 67,762                    | 58,546                        |              | 145,802      |
| <b>Earnings in consolidated subsidiaries</b>              |                                      |             |                           |                               |              |              |
|   | (43,743)                             | 22,273      |                           |                               | 21,470       |              |
| <b>Equity in Earnings of Unconsolidated Joint Venture</b> |                                      |             |                           |                               |              |              |
|   |                                      |             |                           | 626                           |              | 626          |
| <b>Interest Expense (Income), net</b>                     |                                      |             |                           |                               |              |              |
|   | 24                                   | 45,954      | (9,480)                   | 6,986                         |              | 43,484       |
| <b>Income (Loss) Before Income Taxes</b>                  |                                      |             |                           |                               |              |              |
|   | (43,767)                             | (45,903)    | 28,773                    | 1,798                         | 21,470       | (37,629)     |
| <b>Income Tax Expense (Benefit)</b>                       |                                      |             |                           |                               |              |              |
|   | (18)                                 | (2,160)     | 4,681                     | 3,617                         |              | 6,120        |
| <b>Net Income (Loss)</b>                                  |                                      |             |                           |                               |              |              |
|   | \$ (43,749)                          | \$ (43,743) | \$ 24,092                 | \$ (1,819)                    | \$ 21,470    | \$ (43,749)  |

- (1) Kraton Performance Polymers and Polymer Holdings Capital Corporation are the issuers of the 12% Discount Notes. Polymer Holdings Capital Corporation has minimal assets and income. We do not believe that separate financial information concerning the issuers would provide information that would be useful.
- (2) Kraton and Kraton Polymers Capital Corporation are the issuers of the 8.125% Notes. 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 useful.

Index to Financial Statements**KRATON PERFORMANCE POLYMERS, INC.****CONSOLIDATED STATEMENT OF CASH FLOWS**

Year Ended December 31, 2009

(In thousands)

|  | <b>Kraton<br/>Performance<br/>Polymers(1)</b> | <b>Kraton(2)</b> | <b>Guarantor<br/>Subsidiaries</b> | <b>Non-Guarantor<br/>Subsidiaries</b> | <b>Eliminations</b> | <b>Consolidated</b> |
|--|---|------------------|-----------------------------------|---------------------------------------|---------------------|---------------------|
| <b>Cash flows provided by (used in) operating activities</b>             | \$  | \$ (39,221)      | \$ 53,247                         | \$ 58,779                             | \$                  | \$ 72,805           |
| <b>Cash flows provided by (used in) investing activities</b>             |   |                  |                                   |                                       |                     |                     |
| Proceeds from (payments on) intercompany loans                           |   | 79,843           |                                   |                                       | (79,843)            |                     |
| Purchase of plant and equipment, net of proceeds from sales of equipment |   |                  | (28,226)                          | (6,005)                               |                     | (34,231)            |
| Purchase of software   |   |                  | (15,322)                          |                                       |                     | (15,322)            |
| Net cash provided by (used in) investing activities                      |   | 79,843           | (43,548)                          | (6,005)                               | (79,843)            | (49,553)            |
| <b>Cash flows provided by (used in) financing activities</b>             |   |                  |                                   |                                       |                     |                     |
| Proceeds from debt   |   | 144,000          |                                   |                                       |                     | 144,000             |
| Repayment of debt  |   | (308,131)        |                                   |                                       |                     | (308,131)           |
| Cash contribution from member  |   | 126,725          |                                   |                                       | (126,725)           |                     |
| Cash distribution to member  | (126,725)                                     |                  |                                   |                                       | 126,725             |                     |
| Public stock offering  | 126,725                                       |                  |                                   |                                       |                     | 126,725             |
| Deferred financing costs   |   | (3,216)          |                                   |                                       |                     | (3,216)             |
| Proceeds from (payments on) intercompany loans                           |   |                  | (38,592)                          | (41,251)                              | 79,843              |                     |
| Net cash provided by (used in) financing activities                      |   | (40,622)         | (38,592)                          | (41,251)                              | 79,843              | (40,622)            |
| Effect of exchange rate difference on cash                               |   |                  |                                   | (14,735)                              |                     | (14,735)            |
| Net increase (decrease) in cash and cash equivalents                     |   |                  | (28,893)                          | (3,212)                               |                     | (32,105)            |
| <b>Cash and cash equivalents at beginning of period</b>                  |   |                  | 65,460                            | 35,936                                |                     | 101,396             |
| <b>Cash and cash equivalents at end of period</b>                        | \$  | \$               | \$ 36,567                         | \$ 32,724                             | \$                  | \$ 69,291           |

- (1) Kraton Performance Polymers and Polymer Holdings Capital Corporation are the issuers of the 12% Discount Notes. Polymer Holdings Capital Corporation has minimal assets and income. We do not believe that separate financial information concerning the issuers would provide information that would be useful.
- (2) Kraton and Kraton Polymers Capital Corporation are the issuers of the 8.125% Notes. 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 useful.

Index to Financial Statements**KRATON PERFORMANCE POLYMERS, INC.****CONSOLIDATED STATEMENT OF CASH FLOWS**

Year Ended December 31, 2008

(In thousands)

|  | Kraton                     |            | Guarantor    | Non-Guarantor | Eliminations | Consolidated |
|--|----------------------------|------------|--------------|---------------|--------------|--------------|
|  | Performance<br>Polymers(1) | Kraton(2)  | Subsidiaries | Subsidiaries  |              |              |
| <b>Cash flows provided by (used in) operating activities</b>             | \$                         | \$ (7,968) | \$ 83,530    | \$ (35,335)   | \$           | \$ 40,227    |
| <b>Cash flows provided by (used in) investing activities</b>             |                            |            |              |               |              |              |
| Purchase of plant and equipment, net of proceeds from sales of equipment |                            |            | (19,123)     | (4,944)       |              | (24,067)     |
| Proceeds from (payments on) intercompany loans                           |                            | (38,144)   |              |               | 38,144       |              |
| Net cash provided by (used in) investing activities                      |                            | (38,144)   | (19,123)     | (4,944)       | 38,144       | (24,067)     |
| <b>Cash flows provided by (used in) financing activities</b>             |                            |            |              |               |              |              |
| Proceeds from debt   |                            | 316,250    |              |               |              | 316,250      |
| Repayment of debt  |                            | (279,644)  |              |               |              | (279,644)    |
| Cash contribution from member  |                            | 10,000     |              |               |              | 10,000       |
| Proceeds from insurance note payable                                     |                            | (494)      |              |               |              | (494)        |
| Proceeds from (payments on) intercompany loans                           |                            |            | (10,099)     | 48,243        | (38,144)     |              |
| Net cash provided by (used in) financing activities                      |                            | 46,112     | (10,099)     | 48,243        | (38,144)     | 46,112       |
| Effect of exchange rate difference on cash                               |                            |            |              | (9,153)       |              | (9,153)      |
| Net increase (decrease) in cash and cash equivalents                     |                            |            | 54,308       | (1,189)       |              | 53,119       |
| <b>Cash and cash equivalents at beginning of period</b>                  |                            |            | 11,152       | 37,125        |              | 48,277       |
| <b>Cash and cash equivalents at end of period</b>                        | \$                         | \$         | \$ 65,460    | \$ 35,936     | \$           | \$ 101,396   |

- (1) Kraton Performance Polymers and Polymer Holdings Capital Corporation are the issuers of the 12% Discount Notes. Polymer Holdings Capital Corporation has minimal assets and income. We do not believe that separate financial information concerning the issuers would provide information that would be useful.
- (2) Kraton and Kraton Polymers Capital Corporation are the issuers of the 8.125% Notes. 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 useful.

Index to Financial Statements**KRATON PERFORMANCE POLYMERS, INC.****CONSOLIDATED STATEMENT OF CASH FLOWS**

Year Ended December 31, 2007

(In thousands)

|  | Kraton      |             | Guarantor    | Non-Guarantor | Eliminations | Consolidated |
|--|-------------|-------------|--------------|---------------|--------------|--------------|
|  | Performance | Kraton(2)   | Subsidiaries | Subsidiaries  |              |              |
|  | Polymers(1) |             |              |               |              |              |
| <b>Cash flows provided by (used in) operating activities</b>             | \$          | \$ (25,177) | \$ 77,721    | \$ 29,193     | \$           | \$ 81,737    |
| <b>Cash flows provided by (used in) investing activities</b>             |             |             |              |               |              |              |
| Proceeds from (payments on) intercompany loans                           |             | 69,070      |              |               | (69,070)     |              |
| Purchase of plant and equipment, net of proceeds from sales of equipment |             |             | (18,584)     | (10,086)      |              | (28,670)     |
| Net cash provided by (used in) investing activities                      |             | 69,070      | (18,584)     | (10,086)      | (69,070)     | (28,670)     |
| <b>Cash flows provided by (used in) financing activities</b>             |             |             |              |               |              |              |
| Proceeds from debt   |             | 48,500      |              |               |              | 48,500       |
| Repayment of debt  |             | (92,148)    |              |               |              | (92,148)     |
| Proceeds from insurance note payable                                     |             | (245)       |              |               |              | (245)        |
| Proceeds from (payments on) intercompany loans                           |             |             | (61,835)     | (7,235)       | 69,070       |              |
| Net cash provided by (used in) financing activities                      |             | (43,893)    | (61,835)     | (7,235)       | 69,070       | (43,893)     |
| Effect of exchange rate difference on cash                               |             |             |              | (4,498)       |              | (4,498)      |
| Net increase (decrease) in cash and cash equivalents                     |             |             | (2,698)      | 7,374         |              | 4,676        |
| <b>Cash and cash equivalents at beginning of period</b>                  |             |             | 13,850       | 29,751        |              | 43,601       |
| <b>Cash and cash equivalents at end of period</b>                        | \$          | \$          | \$ 11,152    | \$ 37,125     | \$           | \$ 48,277    |

- (1) Kraton Performance Polymers and Polymer Holdings Capital Corporation are the issuers of the 12% Discount Notes. Polymer Holdings Capital Corporation has minimal assets and income. We do not believe that separate financial information concerning the issuers would provide information that would be useful.
- (2) Kraton and Kraton Polymers Capital Corporation are the issuers of the 8.125% Notes. 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 useful.

**Index to Financial Statements**

**KRATON PERFORMANCE POLYMERS, INC.**

**Notes to Consolidated Financial Statements (Continued)**

**15. Financial Instruments, Hedging Activities and Credit Risk**

*Financial Instruments*

*(a) Interest Rate Swap Agreements.* In February 2008, we entered into a \$325 million notional amount interest rate swap agreement to hedge or otherwise protect against Eurodollar interest rate fluctuations on a portion of our variable rate debt. The agreement had a fixed rate of 2.77%, with a margin of 2.0%, which resulted in a total cost of 4.77%, and a term through April 1, 2010. This agreement was designated as a cash flow hedge on the exposure of the variability of future cash flows subject to the variable quarterly interest rates on \$325 million of the term loan portion of the Term Facility. We settled the swap early in June 2008 and realized cash proceeds of \$4.6 million, resulting in a gain on the settlement of \$4.6 million. The gain is deferred in accumulated other comprehensive income at December 31, 2009 and is being reclassified as a reduction in interest expense through March 31, 2010 using the effective interest method, unless we determine that the forecasted interest payments under the Term Facility are probable not to occur, in which case the gain would then be reclassified immediately to interest expense. In 2009, we reclassified \$2.9 million into earnings.

In October 2008, we entered into a \$320 million notional amount interest rate swap agreement to hedge or otherwise protect against Eurodollar interest rate fluctuations on a portion of our variable rate debt. The agreement had a fixed rate of 2.99%, with a margin of 2.0%, which resulted in a total cost of 4.99%, and a term through December 31, 2009. This agreement was designated as a cash flow hedge on the exposure of the variability of future cash flows subject to the variable quarterly interest rates on \$320 million of the term loan portion of the Term Facility. We settled the swap on December 31, 2009 and recorded a loss of \$2.2 million.

In May 2009, we entered into a \$310 million notional amount interest rate swap agreement to hedge or otherwise protect against Eurodollar interest rate fluctuations on a portion of our variable rate debt. This agreement is effective on January 4, 2010 and expires on January 3, 2011 and has a fixed rate of 1.53%, with a margin of 2.0%, which resulted in a total cost of 3.53%. The agreement hedges monthly interest payments from January through December 2010 and expires on January 3, 2011. It has a fixed rate of 1.53% and a margin of 2.0%, which results in a total cost of 3.53%. In December 2009, we made a \$100.0 million payment of outstanding indebtedness under the Term Loans reducing the principal amount outstanding from approximately \$322.6 million to \$222.0 million. As a result, we are required to discontinue hedge accounting prospectively as the hedging relationship fails to meet all of the criteria set forth in ASC 815, specifically the notional amount of the swap and the principal amount of the debt are no longer equal and the forecasted transaction is no longer probable of occurring as documented in the original hedge documentation. We recorded \$0.8 million in interest expense related to the ineffective portion and \$1.9 million in accumulated other comprehensive income related to the effective portion of the hedge. We have elected to dedesignate the initial hedging relationship.

As of January 1, 2008, we adopted the provisions of FASB ASC 820-10, which establishes a three-tier value hierarchy, categorizing the inputs used to measure fair value. The hierarchy can be described as follows: (Level 1) observable inputs such as quoted prices in active markets; (Level 2) inputs other than the quoted prices in active markets that are observable either directly or indirectly; and (Level 3) unobservable inputs in which there is little or no market data, which require the reporting entity to develop its own assumptions.

Index to Financial Statements

## KRATON PERFORMANCE POLYMERS, INC.

## Notes to Consolidated Financial Statements (Continued)

The financial assets and liabilities measured at fair value on a recurring basis are included below:

|                        | December 31,<br>2009 | Fair Value Measurements at Reporting Date Using<br>Quoted Prices<br>in<br>Active<br>Markets<br>for<br>Identical<br>Assets<br>(Level<br>1) |    |       | Significant<br>Other<br>Observable<br>Inputs<br>(Level 2) | Significant<br>Unobservable<br>Inputs<br>(Level 3) |
|------------------------|----------------------|---|----|-------|---|--|
|                        |                      | (in thousands)  |    |       |   |  |
| Derivative liabilities | \$ 2,926             | \$  | \$ | 2,926 | \$  |  |

As of December 31, 2009, the fair market value of the interest rate swap agreement in effect was a liability of approximately \$2.9 million.

*(b) Fair Value of Financial Instruments.*

|                                     | December 31, 2009 |                                 | December 31, 2008 |               |
|-------------------------------------|-------------------|---------------------------------|-------------------|---------------|
|                                     | Carrying<br>Value | Fair<br>Value<br>(in thousands) | Carrying<br>Value | Fair<br>Value |
| Revolving loans                     | \$                | \$                              | \$ 50,000         | \$ 50,000     |
| Term loans                          | 221,729           | 221,729                         | 325,071           | 325,071       |
| 12.00% Discount notes               | 250               | 250                             | 245               | 245           |
| Bonds Payable 8.125% Notes          | 163,000           | 146,089                         | 200,000           | 79,250        |
| 8.125% Notes Held as Treasury Bonds | 7,000             | 6,274                           |                   |               |

The following table presents the carrying values and approximate fair values of our long-term debt at December 31, 2009 and December 31, 2008:

The Term Loans and Revolving Loans are variable interest rate securities, and as such, the fair value approximates their carrying value.

**Foreign Currency Hedge.** On April 3 and July 1, 2008 we entered into two foreign currency option contracts to reduce our exposure to fluctuations in the Euro to U.S. dollar exchange rate for notional amounts of 10 million and 20 million with expiration dates of June 26, and December 29, 2008, respectively. The option contracts do not qualify for hedge accounting. The April, 2008 option contract expired on June 26, 2008 and the July, 2008 option contract expired on December 29, 2008. The impact on our consolidated results of operations, financial position and cash flows was immaterial.

On February 18, 2009 we entered into a foreign currency option contract to reduce our exposure to fluctuations in the Euro to U.S. dollar exchange rate for a notional amount of 47.3 million which expires on December 29, 2009. The option contract does not qualify for hedge accounting. We settled the hedge on December 31, 2009, with a gain of \$1.9 million which represented the mark-to-market impact of the purchased option contract. The gains were recorded in selling, general, and administrative expense on the Consolidated Statements of Operations.

**Credit Risk.** Our customers are diversified by industry and geography with more than 700 customers in over 60 countries. We do not have concentrations of receivables from these industry sectors throughout these countries. The recent global economic downturn may affect our overall credit risk. Where exposed to credit risk, we analyze the counterparties' financial condition prior to entering into an agreement,

establishes credit limits

F-54

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**Index to Financial Statements**

**KRATON PERFORMANCE POLYMERS, INC.**

**Notes to Consolidated Financial Statements (Continued)**

and monitors 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.

**16. Restructuring and Restructuring-related Costs**

As part of our ongoing efforts to improve efficiencies and increase productivity, we have implemented a number of restructuring initiatives in recent years.

We ceased production at the Pernis facility on December 31, 2009, where, prior to the exit we manufactured IR. In connection with the exit, we incurred \$3.9 million in asset retirement obligations, \$6.0 million in restructuring costs and a \$1.1 million non-cash charge to write-down our inventory of spare parts. The estimated asset retirement obligations and restructuring costs of \$5.1 million and \$6.0 million were recorded in the third quarter of 2009, respectively. The asset retirement obligations were adjusted pursuant to the settlement agreement in December 2009. The \$14.9 million of property and equipment related to Pernis was fully depreciated as of December 31, 2009. The settlement agreement calls for total payments of approximately \$10.0 million and will be paid in full on or about May 2010. In January 2010 we made two payments totaling \$7.5 million.

In 2008, we restructured our research and technical service organizations to better align our research and product development capabilities with our customers' needs and market requirements and to focus on our core capabilities, and incurred \$2.2 million of severance and other staffing-related costs which were recorded in research and development expenses in the consolidated statements of operations. Substantially all of the cash expenditures related to these restructurings were paid as of December 31, 2008.

Prior to the 2009 exit from Pernis, on September 20, 2007, we exited the SIS plant at the Pernis facility, and relocated our SIS production to our other production facilities as part of our cost reduction efforts. This resulted in a contractor workforce reduction. The exit plan was completed in the first half of 2008. As a result of exiting the SIS plant, we recorded a liability associated with the plan of approximately \$2.1 million, consisting of \$1.8 million in contractor workforce reduction and \$0.3 million in other associated costs. The entire amount of the charge consisted of cash expenditures in the first and second quarters of 2008.

**17. Subsequent Event**

We have received a communication from a law firm asserting that approximately \$13.5 million in alleged payments to us from SemGroup, L.P. and/or one or more of its affiliates (collectively "SemGroup"), during the 90-day period preceding SemGroup's Chapter 11 bankruptcy filing on July 22, 2008, appear to constitute preferential payments avoidable and recoverable under sections 547 and 550 of the United States Bankruptcy Code. In this regard, no formal claim has been asserted against us in the bankruptcy court as of this date. However, we intend to vigorously defend any such claim if it is made against us, and although the ultimate outcome of any such matter cannot be determined with certainty, we believe we would have a number of defenses to any such claim, including, without limitation, defenses concerning the ordinary course of business and the timing of certain product deliveries made by Kraton to SemGroup prior to the date of its bankruptcy filing. At this time, we have recorded no provision for losses in connection with this matter. Further we do not believe that any claim, if one is asserted, will have a material adverse impact on our business, financial condition, or results of operations.

On January 18, 2010, consistent with our announcement in the third quarter of 2009 of our intent to exit our Pernis, the Netherlands facility, our indirect, wholly-owned subsidiary Kraton Polymers Nederland BV ("Kraton Netherlands") agreed to terminate the following material definitive agreements:

First Amended and Restated Site Services, Utilities, Materials and Facilities Agreement between Kraton Netherlands and Shell Nederland Raffinaderij BV ("SNR") dated 28 February 2001; and





**Index to Financial Statements**

**KRATON PERFORMANCE POLYMERS, INC.**

**Notes to Consolidated Financial Statements (Continued)**

First Amended and Restated Site Services, Utilities, Materials and Facilities Agreement between Kraton Netherlands and Shell Nederland Chemie BV ( SNC, and together with SNR, the Shell Entities ) dated 28 February 2001.

Production at the Pernis facility ceased December 31, 2009. However, the actual termination of these agreements remains subject to the satisfaction of various conditions and is anticipated to become effective on or about May 31, 2010. We expect to maintain a presence at the facility through May 2010, as the site is cleared for demolition beginning thereafter. We currently anticipate transferring IR production to our Belpre, Ohio facility. We are in the process of completing project scoping, including associated capital expenditure requirements, for producing the alternative capacity, and until such alternative production capacity is brought on line, we plan to satisfy customer demand for IR with inventory currently on hand.

On January 7, 2010, the underwriters in our IPO exercised their option to purchase 887,082 additional shares of common stock from our company at the initial public offering price less the underwriting discount to cover over-allotments. Net proceeds from the exercise of the over-allotment option amounted to approximately \$11.2 million. After giving effect to the sale of the shares sold pursuant to the over-allotment option, a total of 11,181,200 shares of our company's common stock were sold in the IPO by us at a price to the public of \$13.50.

We have evaluated significant events and transactions that have occurred and have determined that there were no other events or transactions other than those disclosed in this report that would require recognition or disclosure in our Consolidated Financial Statements for the period ended December 31, 2009.

**Index to Financial Statements**

**Report of Independent Registered Public Accounting Firm**

The Board of Directors and Stockholders

Kraton Performance Polymers, Inc.:

Under date of March 15, 2010, we reported on the consolidated balance sheets of Kraton Performance Polymers, Inc. (formerly Polymer Holdings LLC) and subsidiaries as of December 31, 2009 and 2008, and the related consolidated statements of operations, changes in stockholders' and member's equity and comprehensive income (loss), and cash flows for each of the years in the three-year period ended December 31, 2009, which are included in Kraton Performance Polymers, Inc.'s Annual Report on Form 10-K. In connection with our audits of the aforementioned consolidated financial statements, we also audited the related financial statement schedule in Kraton Performance Polymers, Inc.'s Annual Report on Form 10-K. This financial statement schedule is the responsibility of Kraton Performance Polymers, Inc.'s management. Our responsibility is to express an opinion on this financial statement schedule based on our audits.

In our opinion, the financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

/s/ KPMG LLP

Houston, Texas

March 15, 2010

F-57

Index to Financial Statements

## KRATON PERFORMANCE POLYMERS, INC.

## SCHEDULE II VALUATION AND QUALIFYING ACCOUNTS AND RESERVES

For the Years Ended December 31, 2009, 2008 and 2007

(In thousands)

|                                 | Balance<br>at Beginning<br>of Period | Charged to<br>Costs and<br>Expenses | Deductions | Balance<br>at End of<br>Period |
|---------------------------------|--------------------------------------|-------------------------------------|------------|--------------------------------|
| Allowance for Doubtful Accounts |                                      |                                     |            |                                |
| Year ended December 31, 2009    | \$ 2,512                             | \$ (857)                            | \$ (320)   | \$ 1,335                       |
| Year ended December 31, 2008    | 1,542                                | 2,075                               | (1,105)    | 2,512                          |
| Year ended December 31, 2007    | 2,157                                | 81                                  | (696)      | 1,542                          |

|                              | Balance<br>at Beginning<br>of Period | Charged to<br>Costs and<br>Expenses | Deductions | Balance<br>at End of<br>Period |
|------------------------------|--------------------------------------|-------------------------------------|------------|--------------------------------|
| Inventory Reserves           |                                      |                                     |            |                                |
| Year ended December 31, 2009 | \$ 5,063                             | \$ 1,526                            | \$ (454)   | \$ 6,135                       |
| Year ended December 31, 2008 | 4,755                                | 768                                 | (460)      | 5,063                          |
| Year ended December 31, 2007 | 4,215                                | 2,994                               | (2,454)    | 4,755                          |

F-58

**Index to Financial Statements**

**EXHIBIT INDEX**

The following is a list of all exhibits filed as a part of this annual report on Form 10-K/A, including those incorporated in this annual report by reference.

| <b>Exhibit No</b> | <b>Description of Exhibits</b>  |
|-------------------|---|
| 23.1*             | Consent of Independent Registered Public Accounting Firm  |
| 24.1              | Powers of Attorney (incorporated by reference to Exhibit 24.1 to the Kraton Performance Polymers Inc. s Form 10-K filed with the SEC on March 15, 2010)                   |
| 31.1*             | Certification by CEO pursuant to Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 31.2*             | Certification by CFO pursuant to Rule 13a-14(a) or 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 32.1*             | Certification by CEO and CFO pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002                                     |

\* Filed herewith.