Kraton Performance Polymers, Inc.
Form 10-K
February 28, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

x **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2012

or

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

Commission file number

001-34581

KRATON PERFORMANCE POLYMERS, INC.

(Exact Name of Registrant as Specified in its Charter)

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

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

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

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

None

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

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

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

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

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

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

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

Estimated aggregate market value of the common equity held by nonaffiliates of Kraton Performance Polymers, Inc. at June 30, 2012: $701,891,385. Number of shares of Kraton Performance Polymers, Inc. Common Stock, $0.01 par value, outstanding at February 22, 2013: 32,285,397.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of Kraton Performance Polymers, Inc. s proxy statement for the 2013 Annual Meeting of Shareholders are incorporated by reference in Part III.

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on Form 10-K for

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

Some of the statements in this Annual Report on Form 10-K under the headings Business, Risk Factors, Selected Financial Data, Management s Discussion and Analysis of Financial Condition and Results of Operations, Financial Statements and Supplementary Data and elsewhere contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. We may also make written or oral forward-looking statements in our periodic reports on Forms 10-Q and 8-K, in press releases and other written materials and in oral statements made by our officers, directors or employees to third parties. Statements that are not historical facts, including statements about our beliefs and expectations, are forward-looking statements. Forward-looking statements are often characterized by the use of words such as believes, estimates, expects, projects, may, intends, plans or anticipates, or by discussions of strategy, plans or intentions; anticipated benefits of performance of our products; beliefs regarding opportunities for new, high-margin applications and other innovations; adequacy of cash flows to fund our working capital requirements; our investment in the joint venture with FPCC; scheduled debt payments, interest payments, capital expenditures, benefit plan contributions, and income tax obligations; our anticipated 2013 capital expenditures, including the amount of expenditures related to the semi-works facility, compliance with the MACT rule, health, safety and environmental and infrastructure and maintenance projects, projects to optimize the production capabilities of our manufacturing assets and to support our innovation platform; our ability to meet conditions required to ensure full access to our senior secured credit facility; expectations regarding availability under our credit facility; our plan to prepay certain outstanding indebtedness under our term loans in 2013; expectations regarding our counterparties ability to perform, including with respect to trade receivables; anticipated aggregate and fiscal year 2013 cost estimates for the planned Taiwan manufacturing facility, the portion of such costs we expect to pay, the manner in which we expect to fund such costs, and when we currently expect the facility to become operational; estimates regarding the tax expense of repatriating certain cash and short-term investments related to foreign operations; expectations regarding Nexar ; our ability to realize certain deferred tax assets and our beliefs with respect to tax positions; our plans and expectations regarding our planned Asia expansion project; estimates related to the useful lives of certain assets for tax purposes; our anticipated dividend policy; expectations regarding our pension contributions for fiscal year 2013; estimates or expectations related to monomer costs, ending inventory levels and related estimated charges; the outcome and financial impact of legal proceedings; expectations regarding the spread between FIFO and ECRC in future periods; and projections regarding environmental costs and capital expenditures and related operational savings. Such forward-looking statements involve known and unknown risks, uncertainties and other important factors that could cause the actual results, performance or our achievements, or industry results, to differ materially from historical results, any future results, or performance or achievements expressed or implied by such forward-looking statements. There are a number of risks and uncertainties that could cause our actual results to differ materially from the forward-looking statements contained in this report. Important factors that could cause our actual results to differ materially from those expressed as forward-looking statements are set forth in this report, including but not limited to those under the heading Risk Factors. There may be other factors of which we are currently unaware or deem immaterial that may cause our actual results to differ materially from the forward-looking statements.

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

Presentation of Financial Statements.

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

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

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PART I

Item 1. Business.

General

Our Company

We are a leading global producer of styrenic block copolymers (SBCs) and other engineered polymers. We market our products under the Kraton®, Cariflex™, and NEXAR™ brands. SBCs are highly-engineered synthetic elastomers, which we invented and commercialized almost 50 years ago, that enhance the performance of numerous end use products by imparting greater flexibility, resilience, strength, durability, and processability. Our polymers are typically formulated or compounded with other products to achieve improved, customer-specific performance characteristics in a variety of applications. We seek to maximize the value of our product portfolio by emphasizing complex or specialized polymers and innovations that yield higher margins than more commoditized products. We sometimes refer to these complex or specialized polymers or innovations as being more differentiated. Our products are found in many everyday applications, including personal care products such as disposable diapers and the rubberized grips of toothbrushes, razor blades, and power tools. Our products are also used to impart tack and shear properties in a wide variety of adhesive products and to impart characteristics such as, flexibility and durability in sealants and corrosion resistance in coatings. Our paving and roofing applications provide durability, extending road and roof life. We also produce Cariflex isoprene rubber and isoprene rubber latex. Our Cariflex products are highly-engineered, non-SBC synthetic substitutes for natural rubber and natural rubber latex. Our Cariflex products, which have not been found to contain the proteins present in natural rubber latex and are, therefore, not known to cause allergies, are used in applications such as surgical gloves and condoms. We believe the versatility of Cariflex provides opportunities for new, high margin applications. In addition to Cariflex, we have a portfolio of innovations at various stages of development and commercialization, including polyvinyl chloride (PVC) alternatives for wire, cable and medical applications; polymers for slush molded automotive and faux leather applications; our NEXAR family of membrane polymers for water filtration and breathable fabrics; and synthetic cement formulations and other oilfield applications.

Our total SBC production capacity as of December 31, 2012 was approximately 420 kilotons. Production capacity at our facilities can vary greatly depending upon feedstock, product mix and operating conditions. We generated approximately $1,423.1 million of sales revenue and 313.4 kilotons of sales volume for the year ended December 31, 2012. In 2012, we generated 13.7% of our sales revenue from innovation-driven revenue, which we define as revenue from products or applications introduced in the preceding five years. Our customers are diversified by industry and geography with more than 800 customers in over 60 countries. We manufacture our polymers at five manufacturing facilities globally, including our flagship facility in Belpre, Ohio, as well as facilities in Germany, France, Brazil, and Japan. The facility in Japan is operated by an unconsolidated manufacturing joint venture.

We have had a long-standing relationship with many of our customers and work closely with our customers to design products that meet application-specific performance and quality requirements. We have a diverse customer base, with no single customer accounting for more than 10.0% of our sales revenue in 2012 and our top 10 customers together representing approximately 29.9% of our sales revenue in 2012. Because of the technical expertise and investment required to develop many of our product formulations and the lead times required to replace them, we anticipate that our customers would likely incur additional costs by changing to an alternative vendor.

Over the past several years, we have implemented a range of strategic initiatives designed to enhance our profitability and end use market position. These include fixed asset investments to expand our capacity in specialized products, to enhance productivity at our existing facilities and to reduce our fixed costs through headcount reductions, production line closures at our facility in Pernis, Netherlands and system upgrades. During

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this period, we substantially exited lower margin business such as footwear applications, and implemented pricing strategies designed to enhance our overall margins and return on invested capital. With the commercialization of newer innovations such as NEXAR and HiMA and increasing sales of Cariflex and products for oilfield service applications, our strategy is focused on continuing to shift our portfolio to higher-value, higher margin products, away from lesser-differentiated grades, particularly in our Paving and Roofing and Adhesives, Sealants and Coatings end use markets.

Corporate History

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

Recent Developments

Formation of Joint Venture to Expand Hydrogenated Styrenic Block Copolymer (HSBC) Capacity in Asia. On February 27, 2013, we executed definitive agreements providing for a 50/50 joint venture with Formosa Petrochemical Corporation (FPCC) to build, own and operate a 30 kiloton HSBC plant at FPCC s petrochemical site in Mailiao, Taiwan. Each of Kraton and FPCC will fund 50% of the capital needs of the joint venture that are not satisfied through debt financing. Kraton has exclusive rights to purchase all production from the plant, which it intends to market world-wide, through its global sales and distribution network. Additionally, Kraton will be obligated to purchase a minimum volume each year, with the minimum obligation increasing over the first three years the plant is operational. The joint venture will be a Taiwan entity, with each of Kraton and FPCC having equal representation on the board.

As we previously disclosed, progress on the HSBC joint venture project had been interrupted, initially because of delays in FPCC s obtaining environmental permit approval from the Taiwanese Environmental Protection Agency, and subsequently because when the permit was finally issued in July 2012, it contained conditions FPCC considered to be too restrictive on its overall operations in Mailiao. Due to the uncertainty with respect to FPCC s resolving these conditions, in early October 2012, we opted not to extend our framework agreement with FPCC that had governed the proposed formation of the joint venture, which agreement expired in accordance with its terms on September 30, 2012. The pre-tax impairment charge of $3.4 million for the group of long-lived assets related to the HSBC facility recorded in the third quarter of 2012 will not be affected by the execution of definitive agreements.

Following the expiration of the framework agreement with FPCC, we began in-depth evaluation of options for a stand-alone HSBC expansion project at other locations in the Asia Pacific region. However, during the fourth quarter of 2012, FPCC informed us that it was successful in its efforts to resolve the issue with respect to the conditions attached to the environmental permit. Following this important development, Kraton and FPCC renewed discussions regarding the proposed joint venture, ultimately resulting in the successful execution of definitive documentation to form the venture.

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Based upon current estimates of the construction timeline and subject to timely receipt of all required permits, we anticipate that mechanical completion of the plant could occur as early as mid-2015. At this time, after completing our initial engineering estimate, we anticipate the total project construction cost will be at least $200.0 million. We and FPCC intend to pursue opportunities to obtain debt financing for project costs at the joint venture level. Based on our current assumptions with respect to final project cost, timing and the extent to which the project can be funded through third-party debt financing, we currently estimate our share of the funding for the joint venture will be approximately $50.0 million of which approximately $40.0 million is currently estimated to be funded in 2013. We currently anticipate funding our 2013 contributions with available liquidity.

Products

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

Our products are manufactured along the following primary product lines based upon polymer chemistry and process technologies:

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

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

USBCs. We developed the first USBC polymers in 1964 and built the first dedicated block copolymer facility in Belpre, Ohio, in 1971. As of December 31, 2012, our USBC product portfolio included 105 core commercial grades of products. Sales of USBC products comprised approximately 59.1%, 59.3% and 59.1% of our sales revenue in 2012, 2011 and 2010, respectively.

USBCs are used in three of our core end use markets (Advanced Materials, Adhesives, Sealants and Coatings, and Paving and Roofing) in a range of products to impart performance characteristics such as:

- resistance to temperature and weather extremes in roads and roofing;
- resistance to cracking, reduced sound transmission and better drainage in porous road surfaces;
- impact resistance for consumer plastics; and