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Kraton Performance Polymers, Inc.
Form 10-Q
October 29, 2015

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2015

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

Commission File Number 001-34581

KRATON PERFORMANCE POLYMERS, INC.
(Exact Name of Registrant as Specified in its Charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

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

15710 John F. Kennedy Blvd.
Suite 300
Houston, TX 77032

281-504-4700

(Address of principal executive offices, including zip code)(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer:
Non-accelerated filer:

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

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Number of shares of Kraton Performance Polymers, Inc. Common Stock, \$0.01 par value, outstanding as of October 26, 2015: 30,523,598.

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on Form 10-Q for
Quarter Ended September 30, 2015

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

Some of the statements in this Quarterly Report on Form 10-Q under the headings “Condensed Consolidated Financial Statements” and “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and elsewhere contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. We may also make written or oral forward-looking statements in our periodic reports on Forms 10-K, 10-Q and 8-K, in press releases and other written materials and in oral statements made by our officers, directors or employees to third parties. Statements that are not historical facts, including statements about our beliefs and expectations, are forward-looking statements. Forward-looking statements are often characterized by the use of words such as “outlook,” “believes,” “estimates,” “expects,” “projects,” “may,” “intends,” “plans” or “anticipates,” or by discussions of strategy, plans or intentions; anticipated benefits of or performance of our products; beliefs regarding opportunities for new, differentiated applications and other innovations; adequacy of cash flows to fund our working capital requirements; our investment in the joint venture with Formosa Petrochemical Corporation (“FPCC”); our expectations regarding indebtedness to be incurred by our joint venture with FPCC; our anticipated close of the pending acquisition of Arizona Chemical Holdings Corporation (“Arizona Chemical”); our ability to access adequate financing in order to fund the purchase price for the pending acquisition of all of the outstanding capital stock of Arizona Chemical (the “Arizona Chemical Acquisition”); debt payments, interest payments, benefit plan contributions, and income tax obligations; our anticipated 2015 capital expenditures, 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 fully access our senior secured credit facilities; expectations regarding our counterparties’ ability to perform, including with respect to trade receivables; estimates regarding the tax expense of repatriating certain cash and short-term investments related to foreign operations; expectations regarding differentiated applications; our ability to realize certain deferred tax assets and our beliefs with respect to tax positions; expectations regarding our full year effective tax rate; estimates related to the useful lives of certain assets for tax purposes; expectations regarding our pension contributions for fiscal year 2015; 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; the estimates and matters described under the caption “Item 2. Management’s Discussion and Analysis—Results of Operations—Outlook” and projections regarding environmental costs and capital expenditures and related operational savings. Such forward-looking statements involve known and unknown risks, uncertainties, assumptions and other important factors that could cause the actual results, performance or our achievements, or industry results, to differ materially from historical results, any future results, or performance or achievements expressed or implied by such forward-looking statements. There are a number of risks and uncertainties that could cause our actual results to differ materially from the forward-looking statements contained in this report. Further description of these risks and uncertainties and other important factors are set forth in this report, in our latest Annual Report on Form 10-K, including but not limited to “Part I, Item 1A. Risk Factors” and “Part II, Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations” therein, and in our other filings with the Securities and Exchange Commission, and include, but are not limited to, risks related to:

- failure to successfully close the Arizona Chemical Acquisition, or significant delays in closing the Arizona Chemical Acquisition;
- failure to successfully integrate the business of Arizona Chemical, following the anticipated closing of the Arizona Chemical Acquisition;
- failure to successfully achieve the expected synergies or significant delays in achieving such expected synergies in connection with the Arizona Chemical Acquisition;
- our reliance on LyondellBasell Industries for the provision of significant operating and other services;
- conditions in the global economy and capital markets;
- the failure of our raw materials suppliers to perform their obligations under long-term supply agreements, or our inability to replace or renew these agreements when they expire;
- limitations in the availability of raw materials we need to produce our products in the amounts or at the prices necessary for us to effectively and profitably operate our business;
- significant fluctuations in raw material costs may result in volatility in our quarterly operating results and impact the market price of our common stock;

competition from other producers of styrenic block copolymers and from producers of products that can be substituted for our products;

our ability to produce and commercialize technological innovations;

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

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

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

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seasonality in our business, particularly for sales into paving and roofing applications;
our substantial indebtedness, which could adversely affect our financial condition and prevent us from fulfilling our obligations under our current and future indebtedness;
financial and operating constraints related to our indebtedness;
the inherently hazardous nature of chemical manufacturing;
product liability claims and other lawsuits arising from environmental damage, personal injuries, other damages associated with chemical manufacturing or our products;
lawsuits arising from the termination of the Combination Agreement with LCY Chemical Corp.;
political, economic and local business risks in the various countries in which we operate;
health, safety and environmental laws, including laws that govern our employees' exposure to chemicals deemed harmful to humans;
regulation of our company or our customers, which could affect the demand for our products or result in increased compliance and other costs;
customs, international trade, export control, antitrust, zoning and occupancy and labor and employment laws that could require us to modify our current business practices and incur increased costs;
fluctuations in currency exchange rates;
we may have additional tax liabilities;
our formation of a joint venture to expand hydrogenated styrenic block copolymers capacity in Asia;
our relationship with our employees;
loss of key personnel or our inability to attract and retain new qualified personnel;
the fact that we generally do not enter into long-term contracts with our customers;
a decrease in the fair value of our pension assets could require us to materially increase future funding requirements of the pension plan;
domestic or international natural disasters or terrorist attacks may disrupt our operations;
Delaware law and some provisions of our organizational documents that make a takeover of our company more difficult;
our expectation that we will not pay dividends for the foreseeable future; and
we are a holding company with nominal net worth and will depend on dividends and distributions from our subsidiaries to pay any dividends.

There may be other factors of which we are currently unaware or that we deem immaterial that may cause our actual results to differ materially from the expectations we express in our forward-looking statements. Although we believe the assumptions underlying our forward-looking statements are reasonable, any of these assumptions, and, therefore, also the forward-looking statements based on these assumptions could themselves prove to be inaccurate.

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

Presentation of Financial Statements

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

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

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders

Kraton Performance Polymers, Inc.:

We have reviewed the accompanying condensed consolidated balance sheet of Kraton Performance Polymers, Inc. and subsidiaries (the Company) as of September 30, 2015, the related condensed consolidated statements of operations, and comprehensive loss, for the three-month and nine-month periods ended September 30, 2015 and 2014, and the related condensed consolidated statements of changes in equity, and cash flows for the nine-month periods ended September 30, 2015 and 2014. These condensed consolidated financial statements are the responsibility of the Company's management.

We conducted our review in accordance with the standards of the Public Company Accounting Oversight Board (United States). A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with the standards of the Public Company Accounting Oversight Board (United States), the objective of which is the expression of an opinion regarding the financial statements taken as a whole.

Accordingly, we do not express such an opinion.

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

We have previously audited, in accordance with standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of the Company as of December 31, 2014, and the related consolidated statements of operations, comprehensive income (loss), changes in equity, and cash flows for the year then ended (not presented herein); and in our report dated February 25, 2015, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2014 is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ KPMG LLP

Houston, Texas

October 29, 2015

PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements.

KRATON PERFORMANCE POLYMERS, INC.
 CONDENSED CONSOLIDATED BALANCE SHEETS
 (In thousands, except par value)

| | September 30, 2015 (unaudited) | December 31, 2014 |
|--|--------------------------------------|----------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$63,799 | \$53,818 |
| Receivables, net of allowances of \$263 and \$245 | 110,803 | 107,432 |
| Inventories of products | 264,105 | 326,992 |
| Inventories of materials and supplies | 11,345 | 10,968 |
| Deferred income taxes | 6,976 | 7,247 |
| Other current assets | 27,275 | 24,521 |
| Total current assets | 484,303 | 530,978 |
| Property, plant and equipment, less accumulated depreciation of \$376,294 and \$387,463 | 493,711 | 451,765 |
| Intangible assets, less accumulated amortization of \$97,295 and \$88,939 | 43,360 | 49,610 |
| Investment in unconsolidated joint venture | 11,725 | 12,648 |
| Debt issuance costs | 6,992 | 7,153 |
| Deferred income taxes | 2,973 | 2,176 |
| Other long-term assets | 21,335 | 28,122 |
| Total assets | \$1,064,399 | \$1,082,452 |
| LIABILITIES AND EQUITY | | |
| Current liabilities: | | |
| Current portion of long-term debt | \$139 | \$87 |
| Accounts payable-trade | 64,169 | 72,786 |
| Other payables and accruals | 66,604 | 50,888 |
| Deferred income taxes | 1,549 | 1,633 |
| Due to related party | 15,396 | 18,121 |
| Total current liabilities | 147,857 | 143,515 |
| Long-term debt, net of current portion | 404,799 | 351,785 |
| Deferred income taxes | 12,693 | 15,262 |
| Other long-term liabilities | 103,107 | 103,739 |
| Total liabilities | 668,456 | 614,301 |
| Commitments and contingencies (note 11) | | |
| Equity: | | |
| Kraton stockholders' equity: | | |
| Preferred stock, \$0.01 par value; 100,000 shares authorized; none issued | — | — |
| Common stock, \$0.01 par value; 500,000 shares authorized; 30,524 shares issued and outstanding at September 30, 2015; 31,831 shares issued and outstanding at December 31, 2014 | 305 | 318 |
| Additional paid in capital | 347,462 | 361,342 |
| Retained earnings | 151,092 | 168,041 |
| Accumulated other comprehensive loss | (138,005 |) (99,218 |

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| | | |
|-----------------------------------|-------------|-------------|
| Total Kraton stockholders' equity | 360,854 | 430,483 |
| Noncontrolling interest | 35,089 | 37,668 |
| Total equity | 395,943 | 468,151 |
| Total liabilities and equity | \$1,064,399 | \$1,082,452 |

See Notes to Condensed Consolidated Financial Statements

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KRATON PERFORMANCE POLYMERS, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
 (Unaudited)
 (In thousands, except per share data)

| | Three months ended | | Nine months ended | |
|--|--------------------|-----------|-------------------|------------|
| | September 30, | | September 30, | |
| | 2015 | 2014 | 2015 | 2014 |
| Revenue | \$269,012 | \$318,971 | \$786,349 | \$954,394 |
| Cost of goods sold | 201,202 | 255,147 | 624,542 | 761,417 |
| Gross profit | 67,810 | 63,824 | 161,807 | 192,977 |
| Operating expenses: | | | | |
| Research and development | 7,597 | 7,440 | 23,345 | 23,736 |
| Selling, general and administrative | 26,917 | 16,374 | 77,488 | 78,872 |
| Depreciation and amortization | 16,145 | 16,552 | 46,852 | 49,630 |
| Total operating expenses | 50,659 | 40,366 | 147,685 | 152,238 |
| Earnings of unconsolidated joint venture | 95 | 80 | 273 | 324 |
| Interest expense, net | 6,151 | 6,099 | 17,975 | 18,667 |
| Income (loss) before income taxes | 11,095 | 17,439 | (3,580) |) 22,396 |
| Income tax expense | 3,076 | 1,122 | 4,135 | 3,405 |
| Consolidated net income (loss) | 8,019 | 16,317 | (7,715) |) 18,991 |
| Net loss attributable to noncontrolling interest | (427) |) (298) |) (1,141) |) (858) |
| Net income (loss) attributable to Kraton | \$8,446 | \$16,615 | \$(6,574) |) \$19,849 |
| Earnings (loss) per common share: | | | | |
| Basic | \$0.27 | \$0.51 | \$(0.21) |) \$0.61 |
| Diluted | \$0.27 | \$0.50 | \$(0.21) |) \$0.60 |
| Weighted average common shares outstanding: | | | | |
| Basic | 30,503 | 32,315 | 30,779 | 32,249 |
| Diluted | 30,849 | 32,600 | 30,779 | 32,590 |

See Notes to Condensed Consolidated Financial Statements

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KRATON PERFORMANCE POLYMERS, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
 (Unaudited)
 (In thousands)

| | Three months ended | | Nine months ended | |
|---|--------------------|------------|-------------------|-----------|
| | September 30, | | September 30, | |
| | 2015 | 2014 | 2015 | 2014 |
| Net income (loss) attributable to Kraton | \$8,446 | \$16,615 | \$(6,574) | \$19,849 |
| Other comprehensive loss: | | | | |
| Foreign currency translation adjustments, net of tax of \$0 | (14,972) | (28,587) | (38,787) | (25,651) |
| Other comprehensive loss, net of tax | (14,972) | (28,587) | (38,787) | (25,651) |
| Comprehensive loss attributable to Kraton | (6,526) | (11,972) | (45,361) | (5,802) |
| Comprehensive loss attributable to noncontrolling interest | (2,717) | (1,092) | (2,579) | (1,479) |
| Consolidated comprehensive loss | \$(9,243) | \$(13,064) | \$(47,940) | \$(7,281) |

See Notes to Condensed Consolidated Financial Statements

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KRATON PERFORMANCE POLYMERS, INC.
 CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
 (Unaudited)
 (In thousands)

| | Common Stock | Additional Paid in Capital | Retained Earnings | Accumulated Other Comprehensive Loss | Total Kraton Stockholders' Equity | Noncontrolling Interest | Total Equity |
|---------------------------------|-----------------|----------------------------------|----------------------|---|---|----------------------------|-----------------|
| Balance at December 31, 2013 | \$325 | \$363,590 | \$170,827 | \$ (21,252) | \$ 513,490 | \$ 40,908 | \$554,398 |
| Net income (loss) | — | — | 19,849 | — | 19,849 | (858) | 18,991 |
| Other comprehensive loss | — | — | — | (25,651) | (25,651) | (621) | (26,272) |