Kraton Performance Polymers, Inc.
Form 10-K
February 24, 2016

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, 2015
or
o 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 (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 o NO x
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 o 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 o
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 o
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. o

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:	o
Non-accelerated filer:	o	Smaller reporting company:	o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). YES o NO x

Estimated aggregate market value of the common equity held by nonaffiliates of Kraton Performance Polymers, Inc. at June 30, 2015: $737,458,053. Number of shares of Kraton Performance Polymers, Inc. Common Stock, $0.01 par value, outstanding at February 22, 2016: 30,633,743.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of Kraton Performance Polymers, Inc.'s proxy statement for the 2016 Annual Meeting of Shareholders are incorporated by reference in Part III.

Index to Annual Report on Form 10-K for
Year Ended December 31, 2015

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

Certain statements and information 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 “outlook,” “believes,” “estimates,” “expects,” “projects,” “may,” “intends,” “plans” o “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; beliefs regarding strengthening relationships with customers; 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; expected synergies and cost savings associated with the acquisition of Arizona Chemical Holdings Corporation (“Arizona Chemical”); debt payments, interest payments, benefit plan contributions, and income tax obligations; our anticipated 2016 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 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 2016; estimates or expectations related to raw material costs, ending inventory levels and related estimated charges; the outcome and financial impact of legal proceedings; expectations regarding the spread between FIFO and ECRC (as defined herein) in future periods; the estimates and matters described under the caption “Item 7. 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. 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 in light of new information or future events.

PART I

Item 1. Business.

THE COMPANY

General

We are a leading global specialty chemicals company that manufactures styrenic block copolymers ("SBCs") and other engineered polymers. Effective with the January 6, 2016 acquisition of Arizona Chemical (the "Arizona Chemical Acquisition"), we are now also a leading global producer of value-added specialty products primarily derived from pine wood pulping co-products.

SBCs are highly-engineered synthetic elastomers, which we invented and commercialized over 50 years ago. We developed the first unhydrogenated styrenic block copolymers ("USBC") in 1964 and the first hydrogenated styrenic block copolymers ("HSBC") in the late 1960s. Our SBCs enhance the performance of numerous products by imparting greater flexibility, resilience, strength, durability and processability, and are used in a wide range of applications, including adhesives, coatings, consumer and personal care products, sealants, lubricants, medical, packaging, automotive, paving, roofing and footwear products. We also sell isoprene rubber ("IR") and isoprene rubber latex ("IRL") which are non-SBC products primarily used in applications such as medical products, personal care, adhesives, tackifiers, paints, and coatings.

Following the Arizona Chemical Acquisition, we also refine and further upgrade two primary feedstocks, crude tall oil ("CTO") and crude sulfate turpentine ("CST"), into value-added specialty chemicals. Our pine-based specialty products are sold into adhesive, road and construction and tire markets, and we produce and sell a broad range of chemical intermediates into markets that include fuel additives, oilfield chemicals, coatings, metalworking fluids and lubricants, inks, flavors and fragrances and mining.

Presentation of Financial Statements.

References in this document to "Kraton," "our company," "we," "our," "ours" and "us" as used in this report refer collectively Kraton Performance Polymers, Inc. and its consolidated subsidiaries. Furthermore, these references relate to the combined company including both the legacy Kraton and legacy Arizona Chemical businesses, except for historical financial information and except for the information included in Part II, Items 6 through 9A of the Annual Report on Form 10-K, which pertains to the legacy Kraton businesses only. The information in these items has been presented in this way to provide consistency with Kraton's 2014 financial statements.

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

Strategy

Over the past several years, we have implemented, and continue to implement, a range of strategic initiatives designed to improve our overall cost structure. Our strategic initiatives are intended to: (1) enhance our profitability and market position, with a focus on increasing our scale and optimizing our manufacturing footprint, (2) increase our overall margins and return on invested capital and (3) advance our portfolio of differentiated products, while, at the same time, expanding sales of our core product grades. Strategic initiatives currently include (1) manufacturing optimization, including through our expansion of USBC capacity at our Berre, France facility and leveraging the HSBC capacity under construction by our joint venture, KFPC, located in Mailiao, Taiwan to optimize global HSBC, (2) asset productivity, including through use of the natural gas boilers that replaced the coal-burning boilers at our Belpre, Ohio facility, (3) complexity reduction, including through integrated Cariflex™ manufacturing, and (4) fixed costs management through reduction in selling, administrative and research costs. We realized approximately $19.4 million of total cost savings related to these initiatives during 2015.

Corporate History

Kraton Performance Polymers, Inc. was incorporated in 2009 under Delaware law and is the successor to a Delaware limited liability company, formed in 2003. In December 2009, we completed our initial public offering, and trading in our common stock commenced on the New York Stock Exchange. Certain affiliates of TPG Capital, L.P. and of J.P. Morgan Partners, LLC collectively owned a majority of our common stock following the initial public offering, but sold all of their holdings in our common stock through two secondary public offerings conducted in September 2010 and April 2011. On January 6, 2016, we completed the Arizona Chemical Acquisition. We conduct our business through Kraton Polymers LLC and its consolidated subsidiaries.

RECENT DEVELOPMENTS

Acquisition of Arizona Chemical

On January 6, 2016, we completed the Arizona Chemical Acquisition for a cash purchase price of $1.37 billion, subject to adjustment for cash, indebtedness, working capital and other items. We believe that the Arizona Chemical Acquisition extends our technology and market diversification, creates a more robust platform for growth, and enhances our opportunities to deepen our customer relationships by expanding our presence in our core markets. Arizona Chemical's end use market exposure is highly complementary with that of Kraton, particularly in markets such as adhesives, roads and construction, fuel additives and lubricants, and oilfield chemicals. In addition, the renewable nature of Arizona Chemical's product and technology offerings reduces our overall exposure to hydrocarbon-based feedstocks. See Note 3 Acquisition of Arizona Chemical to the consolidated financial statements for a further description of the Arizona Chemical Acquisition.

The $1.37 billion cash purchase price for the Arizona Chemical Acquisition, the cash tender offer and redemption of all of our outstanding 6.75% senior notes due March 1, 2019 (the "6.75% Senior Notes"), and the related acquisition and financing expenses for the Arizona Chemical Acquisition were funded through the following transactions:

- A $1,350.0 million six-year senior secured first lien term loan facility,
- A private offering of $440.0 million in aggregate principal amount of 10.5% senior notes due 2023, and
- An amended and restated $250.0 million five-year asset-based revolving credit facility, $37.1 million of which was drawn on the closing date.

Our previously outstanding indebtedness under the 6.75% Senior Notes and the former asset-based revolving credit facility consisting of a $150.0 million U.S. senior secured revolving credit facility and a $100.0 million Dutch senior secured revolving credit facility (together, the "Senior Secured Credit Facilities") were satisfied and canceled on January 6, 2016. See Note 19 Subsequent Events to the consolidated financial statements for a further description of the debt issued to finance the Arizona Chemical Acquisition.

Arizona Chemical Products and Commercial Applications. Following the Arizona Chemical Acquisition, we manufacture and sell high value products primarily derived from pine wood pulping co-products. We refine and further upgrade two primary feedstocks, CTO and CST, both of which are co-products of the wood pulping process, into value-added specialty chemicals. We refine CTO through a distillation process into four primary constituent fractions: tall oil fatty acids ("TOFA"), tall oil rosin ("TOR"), distilled tall oil ("DTO"), and tall oil pitch ("Pitch"). We further upgrade TOFA, TOR and DTO into derivatives including dimer acids, polyamide resins, rosin resins, dispersions and disproportionated resins. We refine CST into terpene fractions, which can be further upgraded into terpene resins. The various fractions and derivatives resulting from our CTO and CST refining process provide for distinct functionalities and properties, determining their respective applications and end markets. We focus our resources on four target markets: (1) adhesives, (2) roads & construction, (3) tires and (4) chemical intermediates. Within our target markets, these products are sold into a diverse range of submarkets, including packaging, tapes and labels, pavement marking, high performance tires, fuel additives, oilfield and mining, coatings, metalworking fluids and lubricants, inks, and flavor and fragrances, among others.

While this business is based predominantly on the refining and upgrading of CTO and CST, we have the capacity to use both hydrocarbon-based raw materials, such as alpha-methyl-styrene ("AMS"), rosins and gum rosins where appropriate and, accordingly, are able to offer tailored solutions for our customers.

Arizona Chemical has a portfolio of innovations at various stages of development and commercialization, including:

- adhesive tackifiers designed to enable the use of a higher amount of recycled content in packaging materials;
- high solid adhesive dispersions for labels and tapes that allow for higher coating speeds, which lower process energy costs;
- heat stable rheology, ink resins that reduce formulation complexity for ink manufacturers while improving ink performance;
- high performance tire tread resins that promote wet grip, fuel economy and tire life;
- fuel lubricity improvers that ensure low sulfur targets for diesel fuel can be met;
- bitumen additives for the asphalt paving market that enable high recycled content in asphalt mixes; and
- insolublemaleic rosin esters used in pavement marking binders that provide thermal oxidation resistance.

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Adhesives. We offer a broad range of products to service target adhesives submarkets, including rosin-based tackifiers for packaging and pressure-sensitive adhesive applications, terpene-based tackifiers for bookbinding, hygiene and pressure-sensitive adhesive applications, AMS resins for bookbinding and pressure-sensitive adhesive applications and hot melt polyamides for flexible packaging.

Our tackifiers are primarily used in hot melt adhesives, which are heavily used in the packaging submarket. Our focus in packaging is to improve our competitive position by introducing higher stability tackifiers that work in new polymer systems. We believe our efforts to improve functionality of tackifier offerings will enable differentiated and profitable growth in emerging markets.

Roads and Construction. We provide various products for use in roads and construction applications. Within the pavement marking submarket, we provide rosin based binders for the thermoplastic pavement marking submarket. We have a long-standing history with our customers in this submarket and our manufacturing footprint enables us to provide stable supply, a significant competitive advantage. Within the paving submarket, we sell TOFA for the asphalt paving market and produce rosin esters, insoluble maleic-based tackifiers and niche products including bitumen additives. Our performance bitumen additives were developed specifically to address unmet needs of the asphalt paving market where our technology enables the use of reclaimed asphalt pavement at high levels in an asphalt mix, while meeting local performance specifications. We have a strong market position supported by our increasing expertise in bitumen chemistry for aged materials, a comprehensive understanding of market needs, innovative product solutions and a growing patent portfolio.

Tires. We sell a range of products that enhance the performance and manufacturing of high performance, winter, and all-season tires. Our terpene-based tread enhancement resins optimize wet grip of tire treads while maintaining rolling resistance and durability which contribute to improved vehicle fuel efficiency. We market our AMS-based tread enhancement additives with product attributes including rolling resistance, durability, wet grip enhancement and exceptional compatibility with rubber compounds, especially solution styrene butadiene rubber polymers. We also sell TOFA, DTO and rosins as processing aids which provide select functionalities at various steps in the rubber and tire manufacturing process.

Arizona Chemical was one of the first companies to supply tread enhancement resins to the tire industry and won early qualifications with innovative tire manufacturers. The quest for improved fuel economy has prompted the introduction of silica-based “green tires” of which certain of our products are a key component. AMS resins were the first tread enhancement additive commercialized beyond basic hydrocarbon tackifiers and offer a good balance of properties, price and performance ratio for current generation tires.

Chemical Intermediates. The chemical intermediates market serves various submarkets with a wide product offering and provides value across several different applications including, among others, fuel additives, oilfield chemicals, mining, coatings, metalworking fluids and lubricants, inks, flavors and fragrances. Our products sold into the chemical intermediates market include:

TOFA. Compared to other fatty acids obtained from various vegetable and animal origins, TOFA has a unique chemical composition characterized by distinctive features. For example:

- in coatings, TOFA serves as a binder in solvent-based paints as well as in hybrid coatings, and is preferred over soybean oil due to its higher unsaturation, better reactivity, flexibility and compatibility;
- in mining, TOFA is preferred over oleic acid as lower viscosity and higher affinity with the ore extract allow a higher recovery yield;
- in oilfield chemicals, TOFA is preferred over oleic acid given its easier handling, better solubility in drilling muds, as well as higher surface activity and emulsifying power; and
- in fuel additives, TOFA improves the lubricity of low-sulfur diesel fuel, preventing engine fuel pump wear.

Dimer Acids. Our dimer acids are used for the production of polyamide resins for epoxy coatings, flexographic inks, and high performance adhesive applications. In addition, dimer acids are building blocks in the production of corrosion inhibitors and emulsifiers for the production and recovery of petroleum and natural gas. Major competitors in this area include producers of dimer acid from other feedstocks such as rapeseed and cottonseed oil, and other producers of TOFA-based dimers.

TOR. TOR is used in all major rosin applications for the manufacture of adhesives, inks, pavement markers, rubber, paper and chewing gum.

DTO. DTO is one of the fractions resulting from the CTO refining process, consisting of a mixture of TOFA and rosin acids. Our DTO is primarily used as an emulsifier for metalworking fluids and lubricants, where our product offers performance attributes and, in many cases, replaces less environmentally friendly hydrocarbon-based chemicals. In these applications, it is sometimes used in place of TOFA.

Terpene Fractions. We supply terpene fractions, alpha-pinene and beta-pinene, mainly as specialty tackifiers for the adhesives market and tread enhancers for the tires market. We also sell CST directly to global flavor and fragrance producers.

Belpre Compounding Unit Asset Sale

On January 29, 2016, we sold certain assets to PolyOne Corporation ("PolyOne") including intellectual property, inventory, equipment and other intangible assets associated with our Belpre, Ohio compounding unit (the "BCU"). The BCU is used to manufacture HSBC and USBC based compounds. The $72.0 million purchase price, which was paid in cash at closing, was used to pay down existing indebtedness. In connection with the sale, we entered into a seven year exclusive polymer supply agreement and a compound manufacturing agreement for a transition period of up to two years with PolyOne. Our historical compound sales have primarily been directed into personal care, protective film, consumer, medical & automotive applications, with the compound sales previously reported under the Specialty Polymers business line. Considering both the reduction in sales partially offset by the manufacturing agreement, we expect the divestiture to have a net impact on 2016 EBITDA of approximately $7.0 million.

OUR SBC BUSINESS

Products and Commercial Applications

Our polymer products are high performance elastomers that are engineered for a wide range of 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.

The majority of worldwide SBC production is dedicated to USBCs, which are primarily used in paving, roofing, adhesives, sealants, 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. IR and IRL are non-SBC products which are primarily used in surgical gloves and condoms.

We have a portfolio of innovations at various stages of development and commercialization, including:

- polyvinyl chloride alternatives for wire and cable and medical applications;
- polymers and compounds for soft skin and coated fabric applications for transportation and consumer markets;
- highly-modified asphalt ("HiMA") for high-performance paving applications;
- a family of high melt flow polymers for use in soft touch overmolding, protective cling films and other polymer modification applications;
- NEXAR™ polymers for heating, ventilation, air conditioning and breathable fabrics; and
- synthetic cement formulations and polymers used for viscosity modification in oilfield applications.

Our polymer products are manufactured and our commercial activities are organized in the following product groups based upon polymer chemistry and process technologies:

	Revenue Mix ($ in millions)								
Product Groups	2015			2014			2013		
Performance Products	$540.6	52.3	%	$678.9	55.2	%	$762.9	59.0	%
Specialty Polymers	$350.7	33.9	%	$412.4	33.5	%	$412.0	31.9	%
Cariflex	$142.9	13.8	%	$138.6	11.3	%	$116.0	9.0	%
Other	$0.4	—	%	$0.5	—	%	$1.2	0.1	%

Performance Products. For the years ended December 31, 2015, 2014 and 2013, our Performance Products, which are USBC products, generated revenue into the following product applications:

	Performance Products Revenue Mix					
Application:	2015		2014		2013	
Paving	27	%	26	%	27	%
Roofing	18	%	18	%	18	%
Personal care	20	%	20	%	19	%
Packaging & industrial adhesives	18	%	19	%	19	%
Industrial	7	%	7	%	6	%
Other	10	%	10	%	11	%

Our Performance Products impart 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; and
- increased processing flexibility in adhesive applications, such as packaging tapes and labels, and materials used in disposable diapers.

In paving and roofing applications, our Performance Products primarily consist of styrene-butadiene-styrene (“SBS”)-modified asphalt, which in roofing applications produces stronger and more durable felts and shingles, and in paving applications enhances the strength and elasticity of asphalt-based paving compositions over an extended temperature range. In paving applications, we believe our HiMA technology polymers will extend road life by allowing pavements to withstand heavy traffic loads and varying climate conditions. Our products primarily compete with chemicals such as styrene-butadiene rubber latex, acetates, polyphosphoric acids and thermoplastic materials like ethylene-propylene-diene-monomer (“EPDM”), polyethylene, atactic polypropylene and unmodified asphalts. We believe that customer choice for these markets is driven principally by total end-product cost, temperature performance, bitumen source and application.

In personal care applications, our Performance Products primarily consist of SBS and styrene-isoprene-styrene (“SIS") for the manufacturing of ultra-thin stretchable films used for the production of diapers. In addition, our SIS polymers are also used in the lamination process for other personal care products. Our products primarily compete against low priced alternatives such as metallocenes. We believe that customer choice for these markets is driven principally by total end-product cost and performance.

In adhesives applications, our Performance Products primarily compete with ethylene-vinyl acetate, polyolefines, and metallocene polyolefins. The choice between these materials is influenced by bond strength, specific adhesion, consistent performance to specification, processing speed, hot-melt application, resistance to water and total end-product cost. Our SBCs are compatible with many other formulating ingredients. We believe demand for utilization of SBC based adhesives is primarily driven by cost reduction and higher performance.

Specialty Polymers. Our Specialty Polymers are comprised of HSBC products which are significantly more complex to produce than our Performance Products, which are USBC products. As a result, our Specialty Polymers generally generate higher margins than our Performance Products. For the years ended December 31, 2015, 2014 and 2013, our Specialty Polymers revenue included sales into the following product applications:

	Specialty Polymers Revenue Mix					
Application:	2015		2014		2013	
Lubricant additives	14	%	20	%	16	%
Polymer modification	13	%	13	%	13	%
Personal care	10	%	12	%	16	%
Medical	10	%	8	%	8	%
Cable gels	7	%	9	%	7	%
Adhesives and coatings	7	%	7	%	6	%
Industrial	7	%	5	%	4	%
Consumer	5	%	4	%	5	%
Other	27	%	22	%	25	%

Our Specialty Polymers impart characteristics such as:

- improved flow characteristics for many industrial and consumer sealant and lubricating fluids;
- soft feel in numerous consumer products such as razor blades, power tools, and automobile components;
- impact resistance for demanding engineered plastic applications;
- flexibility for wire and cable plastic outer layers;
- stretch properties in disposable diapers and adult incontinence products;
- resistance to ultraviolet light;
- processing stability and viscosity; and
- elevated temperature resistance

Our products primarily compete against a variety of chemical and non-chemical alternatives including, but not limited to, thermoplastic vulcanizate, thermoplastic polyurethane, PVC, thermoplastic polyolefin, polyethylene terephthalate, polycarbonate, polyamide and ethylene-propylene-diene-monomer based products. We believe demand for our Specialty Polymers portfolio is principally driven by customer-specific needs and by the ability to balance performance characteristics such as soft-touch, durability, stretch and impact.

Since many of our products are highly engineered and customized formulations, they require specialized product testing and validation, production and process evaluation. This results in a long lead time to achieve customer and industry established approvals. Our innovation led growth strategy focuses on translating the inherent strengths of our product technologies such as flexibility, resilience, impact and moisture resistance, and aesthetics (clarity and haptics) to target opportunities where we can expand and/or have the potential to create new market spaces for our solutions.

Cariflex™. We market our IR and IRL products under the Cariflex brand name. These products combine the key qualities of natural rubber, such as good mechanical properties and hysteresis, with purity and clarity enhancements, good flow, low gel content, and absence of nitrosamines and natural rubber proteins. For the years ended December 31, 2015, 2014 and 2013, our Cariflex revenue included sales into the following product applications:

	Cariflex Revenue Mix					
Application:	2015		2014		2013	
Medical	94	%	94	%	94	%
Industrial	6	%	6	%	6	%

IR (formed from polymerizing isoprene) is a high purity, non-SBC product. Our IR polymers are available as bales of rubber or as latex. We focus our IR polymers in demanding applications such as medical products, paints, coatings and specialized footwear. IRL (emulsion of IR in water) is a substitute for natural rubber latex, particularly in applications with high purity requirements, such as medical, healthcare, personal care and food contact operations. Our IRL is specialized polyisoprene latex with a controlled structure and low chemical impurity levels obtained through an anionic polymerization process followed by a proprietary latex processing step, both of which were first developed by us. IRL is durable, tear resistant, soft, transparent and odorless. In addition, the synthetic material is non-allergenic and has superior consistency and other advantages to natural rubber latex. IRL is predominately used in synthetic surgical gloves and condoms.

Our products primarily compete with natural rubber, conventional Ziegler Natta sourced solid IR, halo butyl rubber and several synthetic latex alternatives, notably neoprene, nitrile and polychloroprene latex rubber, as well as polyurethane.

We have undertaken several projects to support anticipated continued growth in demand for our Cariflex™ products. During 2011, we successfully completed the expansion of our IRL capacity at our Paulinia, Brazil, facility, and more recently, two manufacturing line expansions were completed by our contracted supplier in Japan, more than doubling our previous capacity in Japan.

GENERAL

Sales and Marketing

Our business is predominantly based on a short sales cycle. We sell our products through a number of channels including a direct sales force, marketing representatives and distributors. We use third-party marketing representatives and distributors in markets where they have existing platforms and are more cost effective in completing market coverage. We have long-term relationships and a wide network of distributors across North America, Europe, Latin America and Asia Pacific.

Our sales personnel are primarily responsible for maintaining relationships with our customer base to provide product advice. In general, they arrange and coordinate contact between our customers and our research and development personnel to provide quality control and new product solutions. Our close interaction with our customers has allowed us to develop and maintain what we consider to be strong customer relationships.

For geographic reporting, revenue is attributed to the geographic location in which the customers’ facilities are located. See Note 14 Industry Segment and Foreign Operations to the consolidated financial statements for geographic reporting of revenue and long-lived assets. We generated our revenue from customers located in the following regions:

Revenue by Geography:	2015		2014		2013	
Americas	38.4	%	38.9	%	39.3	%
Europe, Middle East and Africa	33.1	%	36.4	%	38.7	%
Asia Pacific	28.5	%	24.7	%	22.0	%

Competition

In each of our markets, we compete on the basis of a range of factors, including price, breadth of product availability, product quality and the speed of service from order to delivery. We believe our customers also base their supply decisions on the supplier’s ability to design and produce customized products and the availability of technical support. We also compete against a broad range of alternative materials throughout our product groups, including petrochemical, animal and vegetable-based substitutes.

Industry. Our most significant competitors in the specialty chemicals industry are: (1) other SBC producers, including Asahi Chemical, Chi Mei, Dynasol, Kuraray, Korea Kumho, LCY, LG Chemical, Sinopec, TSRC, Versalis, Sibur Voronezh and Zeon Corporation and, following the Arizona Chemical acquisition, (2) other pine chemical manufacturers, including Ingevity, Harima Lawter, Inc., Les Dérivés Résiniques et Terpéniques, Georgia-Pacific LLC, and Respol Group, (3) gum rosin processors, including Harima Lawter Inc. and (4) companies that refine and upgrade hydrocarbons or vegetable oil, including ExxonMobil Corp., Eastman Chemical Company, Archer-Daniels-Midland Company, BASF SE, Cargill, Inc., Energy Oleo Chemicals LLC, KLK Oleo, Oleon NV and Vantage Oleon Chemicals. Generally, however, we believe individual competitors do not compete across all of our product applications.

Sources and Availability of Raw Materials

For the production of SBCs, we use butadiene, styrene and isoprene (also referred to as “monomers”) as our primary raw materials in manufacturing our products. On a first-in, first-out basis of accounting (“FIFO”), these monomers together represented approximately $385.2 million, or 47.8%, of our total cost of goods sold for the year ended December 31, 2015.

For our SBC facilities in the U.S., we procure a substantial majority of our monomers from U.S. suppliers pursuant to contractual arrangements generally having terms ranging from one to two years, subject to renewal conditions. In Europe, we source our butadiene pursuant to long-term contracts in effect through 2040 and 2023 for our Wesseling, Germany, and Berre, France, facilities, respectively. We source styrene and isoprene in Europe through a variety of short term contractual arrangements. In Brazil, we generally purchase all our raw materials from local third-party suppliers under short term contractual arrangements. In Japan, butadiene and isoprene are supplied under our joint venture agreement with JSR Corporation ("JSR") and styrene is sourced from local third-party suppliers.

Following the Arizona Chemical Acquisition, we have an exclusive long-term supply contract with International Paper, through 2027, pursuant to which they have agreed to sell to us, and we agreed to purchase from them, all of the CTO and CST produced at their paper mills. We also maintain long-standing relationships with other major suppliers of CTO and CST in the United States and Europe. Additionally, our CTO supply sources are further diversified by our ability to refine and process Black Liquor Soap ("BLS") into CTO in the U.S. Most of Arizona Chemical's manufacturing facilities are located in close proximity to the facilities of our raw material suppliers, allowing us to procure our raw materials at a low delivered cost. Furthermore, we work directly with our suppliers at their production facilities to enhance their CTO and CST yields through technological improvements, which maximize our raw material supplies, improve the efficiency of our suppliers' operations and enable us to foster strong, long-lasting relationships with them.

Operating Agreements

LyondellBasell operates our manufacturing facilities located in Berre, France, and Wesseling, Germany. LyondellBasell charges us fees based on specified costs incurred in connection with operating and maintaining these facilities as specified in each respective agreement. LyondellBasell employs and provides all staff, other than certain managers, assistant managers and technical personnel, whom we may appoint. The operating agreement for our Berre facility has an unlimited term, but is terminable as of any date after December 31, 2020 following a minimum 18 months notice by either party. The operating agreement for our Wesseling facility is effective through March 31, 2040 and termination requires a five year prior written notice.

Research, Development and Technology

Our research and development program is designed to develop new products and applications, provide technical service to customers, develop and optimize process technology, and assist in marketing new products. We spent $31.0 million, $31.4 million and $32.0 million for research and development for the years ended December 31, 2015, 2014 and 2013, respectively. We also engage in customer-sponsored research projects; with average spending of approximately $1.0 million a year for the three-year period ended December 31, 2015.

Our research and development activities are primarily conducted in laboratories in Houston, Texas, and Amsterdam, the Netherlands. In addition, we launched a semi-works facility in 2014 at our Belpre, Ohio, plant which accelerates polymer development efforts and commercialization of products including the reduction of customer qualification lead times. Following the Arizona Chemical Acquisition, we have additional research and development laboratories in Savannah, Georgia, Almere, the Netherlands, and Shanghai, China.

Patents, Trademarks, Copyrights and Other Intellectual Property Rights

We rely on a variety of intellectual property rights to conduct our business, including patents, trademarks and trade secrets. In 2015, we were awarded 63 patents for new products or applications, and at December 31, 2015, we had 989 granted patents and 328 pending patent applications. Following the Arizona Chemical Acquisition, we obtained an additional 225 granted patents, with a further 129 pending patent applications as of the transaction close date. These patents protect our innovative technologies and applications against infringement, and create long-term, sustainable competitive advantages in our core growth markets. Since patents are generally in effect for a period of 20 years from the filing date, and therefore, assuming most of these applications will be granted, a significant portion of our patent portfolio is expected to remain in effect for a long period. The granted patents and the applications cover both the United States and foreign countries. We do not expect that the expiration of any single patent or specific group of patents would have a material impact on our business and the overall profitability of our business is not dependent on any single patent, trademark, license or franchise.

Our material trademarks will remain in effect unless we decide to abandon any of them, subject to possible third-party claims challenging our rights. Similarly, our trade secrets will preserve their status as such for as long as they are the subject of reasonable efforts, on our part, to maintain their secrecy. We maintain a number of trade names which are protected by trademark laws.

Employees

As of December 31, 2015, we had 917 employees. In addition, 172 LyondellBasell manufacturing employees operate our manufacturing facilities and provide maintenance services in Europe under various operating and services arrangements. See “Operating Agreements.” As of the closing date of the Arizona Chemical Acquisition, Arizona Chemical had 1,112 employees.

Environmental Regulation

Our operations in the United States and abroad are subject to a wide range of environmental laws and regulations at the international, national, state and local levels. Matters pertaining to the environment are discussed in Part I, Item 1A. Risk Factors; Part I, Item 3. Legal Proceedings; and Part II, Item 7. Management’s Discussion and Analysis of Financial Condition and Results of Operations.

We have made, and intend to continue to make, the expenditures necessary for compliance with applicable laws and regulations relating to environmental, health and safety matters. We incurred capital expenditures in 2015 for environmental purposes of $4.5 million, and estimate such expenditures to be approximately $15.0 million in 2016 and $15.0 million to $20.0 million in 2017.

Costs of remediation at our current and former facilities are covered by indemnification agreements, insurance or through allocated reserves. We currently estimate that the costs of remediation will not materially affect our operations or cause us to materially exceed our anticipated level of capital expenditures. Although resolution of environmental liabilities will require future cash outlays, it is not expected that such outlays will materially impact our liquidity position, although there can be no assurance that such impacts could not occur.

Seasonality

Seasonal changes and weather conditions typically affect our sales of products in our paving, roofing, and construction applications, which generally results in higher sales volumes in the second and third quarters of the calendar year compared to the first and fourth quarters of the calendar year. Sales for our other product applications tend to show relatively little seasonality.

For Arizona Chemical, seasonality typically affects the availability of CTO and CST, our primary raw materials. Yields of CTO and CST are higher during the first half of the year, generally peaking during the early summer months, due to the natural growth and associated chemical yield cycles of trees in addition to higher yields from kraft pulping during the cooler months.

Available Information

We electronically file reports with the Securities and Exchange Commission (SEC), including annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to such reports. The public may read and copy any materials that we file with the SEC at the SEC’s Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC also maintains an internet site that contains reports and information statements, and other information regarding issuers that file electronically with the SEC at http://www.sec.gov. Additionally, information about us, including our reports filed with the SEC, is available through our web site at http://www.kraton.com. Such reports are accessible at no charge through our web site and are made available as soon as reasonably practicable after such material is filed with or furnished to the SEC. Our website and the information contained on that site, or connected to that site, are not incorporated by reference into this report.

Item 1A. Risk Factors.

Failure to successfully integrate Arizona Chemical in the expected time frame may adversely affect our future results, including the realization of anticipated cost synergies and the incurrence of additional and/or unexpected costs in order to realize them.

The success of the Arizona Chemical Acquisition will depend substantially on our ability to realize the anticipated benefits and cost synergies from combining our business with Arizona Chemical's business. To realize these anticipated benefits, the businesses must be successfully integrated and combined, and we will incur substantial costs to do so. We currently estimate the cost to achieve expected annual synergies of approximately $65.0 million (expected to be fully realized by 2018) to be approximately $50.0 million over the three-year period following closing of the Arizona Chemical Acquisition and in addition, we may incur future costs associated with integrating the businesses. There can be no assurance that we will be able to realize the anticipated cost synergies from the Arizona Chemical Acquisition in the anticipated amounts or within the anticipated timeframes or costs expectations, or at all. The combined organization may not be able to achieve its objectives or expected synergies for a number of reasons, including, but not limited to, the following: (i) we may fail to integrate the Arizona Chemical business with our existing business into a cohesive, efficient enterprise; (ii) our resources, including management resources, are limited and may be strained, and the Arizona Chemical Acquisition may divert our management's attention from initiating or carrying out programs to save costs or enhance revenues; (iii) our failure to retain key employees and contracts of Arizona Chemical; and (iv) there may be operating problems or liabilities that were not identified prior to closing of the Arizona Chemical Acquisition. In addition, costs to achieve anticipated synergies and benefits may exceed our estimates, and the actual integration may result in additional and unforeseen expenses, which could reduce the anticipated benefits of the Arizona Chemical Acquisition.

Assumptions relating to these cost synergies involve subjective decisions and judgments. Although our management team believes these estimates and assumptions to be reasonable, any of the assumptions could be inaccurate. The internal financial projections used to calculate anticipated cost synergies also do not take into account any circumstances or events occurring after the date on which they were prepared. These internal financial projections reflect assumptions as to certain business decisions that are subject to change. Accordingly, there can be no assurance that the internal financial projections and the related anticipated cost synergies will be realized or that actual results will not be significantly higher or lower than projected. We undertake no obligation to update or otherwise revise or reconcile these internal financial projections and the related anticipated cost synergies whether as a result of new information, future events or otherwise.

Our substantial indebtedness could adversely affect our financial condition and prevent us from fulfilling our obligations under our indebtedness, including our senior notes and our senior secured credit facilities.

As of December 31, 2015, we had $350.0 million principal amount of indebtedness outstanding in the form of the 6.75% Senior Notes and our former Senior Secured Credit Facilities which were undrawn, with available borrowing capacity of $165.5 million. In connection with the Arizona Chemical Acquisition we:

- conducted a cash tender offer and redemption for the 6.75% Senior Notes;
- entered into a new $1,350.0 million first lien term loan (the "Term Loan Facility");
- amended our former senior secured credit facilities to a $250.0 million asset-based credit facility (the "ABL Facility"), under which we drew $37.1 million; and
- issued $440.0 million of 10.5% senior notes due 2023 (the "10.5% Senior Notes").

Under our new Term Loan Facility and amended ABL Facility, we may request up to an aggregate of $350.0 million and $100.0 million, respectively, of additional facility commitments subject to compliance with certain covenants and other conditions. In addition, our KFPC joint venture executed a syndicated loan agreement in the amount of 5.5 billion new Taiwanese dollars ("NTD"), or $167.5 million (converted at the December 31, 2015 exchange rate), to provide additional funding to construct the HSBC facility in Taiwan and to provide funding for working capital requirements and/or general corporate purposes. FPCC and Kraton Polymers LLC are the guarantors of the KFPC Loan Agreement with each guarantor guaranteeing fifty percent (50%) of the indebtedness, of which NTD 2.5 billion, or $76.9 million (converted at the December 31, 2015 exchange rate), of indebtedness was outstanding as of December 31, 2015.

Although the agreements governing the Term Loan Facility, the ABL Facility, the 10.5% Senior Notes, and the KFPC Loan Agreement contain restrictions on the incurrence of additional indebtedness, these restrictions are subject to a number of important exceptions, and additional indebtedness that we may incur from time to time to finance projects or for other reasons in compliance with these restrictions could be substantial. If we and our restricted subsidiaries incur significant additional indebtedness, the related risks that we face could increase.

Our indebtedness could:

- make it more difficult for us to satisfy our financial obligations;
- increase our vulnerability to adverse economic and industry conditions;
- increase the risk that we breach financial covenants and other restrictions in our debt agreements, which can be exacerbated by volatility in the cost of our raw materials and the resulting impact on our earnings;
- require us to dedicate a substantial portion of our cash flow from operations to make payments on our indebtedness, thereby reducing the availability of our cash flow to fund working capital, capital expenditures and other general corporate purposes;
- limit our flexibility in planning for, or reacting to, changes in the business and industry in which we operate;
- restrict us from exploiting business opportunities;
- place us at a disadvantage compared to our competitors that have less debt and lease obligations; and
- limit our ability to borrow additional funds for working capital, capital expenditures, acquisitions, debt service requirements, execution of our business strategy and other general corporate purposes or to refinance our existing debt.

Our ability to pay principal of and interest on indebtedness, fund working capital and make anticipated capital expenditures depends on our future performance, which is subject to general economic conditions and other factors, some of which are beyond our control. There can be no assurance that our business will generate sufficient cash flow from operations or that future borrowings will be available under the ABL Facility to fund liquidity needs, including debt service. Furthermore, if we decide to undertake additional investments in existing or new facilities, this will likely require additional capital, and there can be no assurance that this capital will be available.

Despite current indebtedness levels and restrictive covenants, we and our subsidiaries may incur additional indebtedness or we may pay dividends in the future. This could further exacerbate the risks associated with our substantial financial leverage.

We and our subsidiaries may incur significant additional indebtedness in the future under the agreements governing our indebtedness. Although the terms of the Term Loan Facility, the ABL Facility and the 10.5% Senior Notes contain restrictions on the incurrence of additional indebtedness and the payment of distributions to our equity holders, these restrictions are subject to a number of thresholds, qualifications and exceptions, and the additional indebtedness incurred, and distributions paid, in compliance with these restrictions could be substantial. Additionally, these restrictions also permit us to incur obligations that, although preferential to our common stock in terms of payment, do not constitute indebtedness. As of the date of this filing, $37.0 million was drawn on the ABL Facility with a remaining available borrowing capacity of $176.9 million. In addition, if new debt is added to our and/or our subsidiaries' debt levels, the related risks that we now face as a result of our leverage would intensify.

Our current and future debt instruments may impose significant operating and financial restrictions on us and affect our ability to access liquidity.

Our current debt instruments do, and any future debt instruments may, contain a number of restrictive covenants that impose significant operating and financial restrictions on us. Under the terms of our ABL Facility, we are subject to a financial covenant requiring us to maintain a fixed charge coverage ratio of 1.0 to 1.0 if availability under the facility is below specified amounts. In addition, our Term Loan Facility includes a senior secured net leverage ratio covenant which shall not exceed 4.00:1.00 through March 31, 2017 reducing over time to 3.25:1.00 in 2019. In addition, our debt instruments may include restrictions on our ability to, in certain circumstances, among other things:

- place liens on our or our restricted subsidiaries' assets;
- make investments other than permitted investments;
- incur additional indebtedness;
- merge, consolidate or dissolve;
- sell assets;
- engage in transactions with affiliates;
- change the nature of our business;
- change our or our subsidiaries' fiscal year or organizational documents; and
- make restricted payments (including certain equity issuances).

A failure by us or our subsidiaries to comply with the covenants and restrictions contained in the agreements governing our indebtedness could result in an event of default under such indebtedness, which could adversely affect our ability to respond to changes in our business and manage our operations. Upon the occurrence of an event of default under any of the agreements governing our indebtedness, the lenders could elect to declare all amounts outstanding to be due and payable and exercise other remedies as set forth in the agreements. Further, an event of default or acceleration of indebtedness under one instrument may constitute an event of default under another instrument. If any of our indebtedness were to be accelerated, there can be no assurance that our assets would be sufficient to repay this indebtedness in full, which could have a material adverse effect on our ability to continue to operate as a going concern.

To service our indebtedness, we will require a significant amount of cash.

Our ability to generate cash depends on many factors beyond our control, and any failure to meet our debt service obligations could harm our business, financial condition and results of operations. Our ability to make payments on and to refinance our indebtedness, and to fund working capital needs and planned capital expenditures, will depend on our ability to generate cash in the future. This, to a certain extent, is subject to general economic, financial, competitive, business, legislative, regulatory and other factors that are beyond our control, including, among other things, the costs of raw materials used in the production of our products.

If our business does not generate sufficient cash flow from operations or if future borrowings are not available to us in an amount sufficient to enable us to pay our indebtedness, or to fund our other liquidity needs, we may need to refinance all or a portion of our indebtedness, on or before the maturity thereof, sell assets, reduce or delay capital investments or seek to raise additional capital, any of which could have a material adverse effect on our operations. We might not generate sufficient cash flow to repay indebtedness as currently anticipated. In addition, we may not be able to effect any of these actions, if necessary, on commercially reasonable terms or at all. Our ability to restructure or refinance our indebtedness, will depend on the condition of the capital markets and our financial condition at such time. Any refinancing of our indebtedness could be at higher interest rates and may require us to comply with more onerous covenants, which could further restrict our business operations. The terms of existing or future debt instruments may limit or prevent us from taking any of these actions. In addition, any failure to make scheduled payments of interest and principal on our outstanding indebtedness would likely result in a reduction of our credit rating, which could harm our ability to incur additional indebtedness on commercially reasonable terms or at all. Our inability to generate sufficient cash flow to satisfy our debt service obligations, or to refinance or restructure our obligations on commercially reasonable terms or at all, would have a material adverse effect on our business, financial condition and results of operations.

Our variable rate indebtedness subjects us to interest rate risk, which could cause our debt service obligations to increase significantly.

Borrowings under the Term Loan Facility and the ABL Facility are at variable rates of interest and expose us to interest rate risk. Interest rates are currently at historically low levels. If interest rates increase, our debt service obligations on the variable rate indebtedness will increase even though the amount borrowed will remain the same, and our net income and cash flows, including cash available for servicing our indebtedness, will correspondingly decrease. Following the close of the Arizona Chemical Acquisition on January 6, 2016, approximately $1,350.0 million of our debt would have been variable rate debt, and, holding other variables constant, an increase or decrease in interest rates by 0.125% on our variable rate debt would increase or decrease our annual interest expense by approximately $1.7 million. Subsequent to the close of our Term Loan Facility, we entered into a series of interest rate swaps for a portion of the forecasted Term Loan Facility balance effective in January 2017 whereby we exchanged floating for fixed rate interest payments in order to reduce exposure to interest rate volatility. However, interest rate swaps we entered may not fully mitigate our interest rate risk.

Conditions in the global economy and capital markets may adversely affect the company’s results of operations, financial condition and cash flows.

Our products are sold in markets that are sensitive to changes in general economic conditions, such as automotive, construction and consumer products. Downturns in general economic conditions can cause fluctuations in demand for our products, product prices, sales volumes and margins. A decline in the demand for our products or a shift to lower-margin products due to deteriorating economic conditions could adversely affect sales of our products and our

profitability and could also result in impairments of certain of our assets.
Our business and operating results have been affected by fluctuating commodity prices, volatile exchange rates and other challenges currently affecting the global economy and our customers. Uncertainty regarding global economic conditions poses a continuing risk to our business, as consumers and businesses may postpone spending in response to tighter credit, negative financial news or declines in income or asset values, which may reduce demand for our products. If global economic and market conditions, or economic conditions in key markets, remain uncertain or deteriorate further, our results of operations, financial condition and cash flows could be materially adversely affected.

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, could increase our cost for these materials, interrupt production or otherwise adversely affect our results of operations.

Our manufacturing processes use the following primary raw materials: butadiene, styrene, isoprene, CTO, including black liquor soap that we refine into CTO and CST. We have entered into long-term supply agreements with Shell Chemicals, LyondellBasell, International Paper and others to supply our raw material needs in the United States and Europe.

In addition, most of our long-term contracts contain provisions that allow our suppliers to limit, or allocate, the amount of raw materials shipped to us below the contracted amount in certain circumstances. If we are required to obtain alternate sources for raw materials because a supplier is unwilling or unable to perform under raw material supply agreements, if a supplier terminates its agreements with us, if we are unable to renew our existing contract, or if we are unable to obtain new long-term supply agreements to meet changing demand, we may not be able to obtain these raw materials in sufficient quantities or in a timely manner, and we may not be able to enter into long-term supply agreements on terms as favorable to us, if at all. A lack of availability of raw materials could have a material adverse effect on our results of operations, financial condition and cash flows.

If the availability of isoprene is limited, we may be unable to produce some of our products in quantities or on economic terms sought by our customers, which could have an adverse effect on our sales of products requiring isoprene.

Isoprene is not widely available, and the few isoprene producers tend to use their production for captive manufacturing purposes or to sell only limited quantities into the world chemicals market. As a result, there is limited non-captive isoprene available for purchase in the markets in which we operate.

Currently, we source our isoprene requirements for the United States and Europe from a portfolio of suppliers. In Japan, we obtain the majority of our isoprene requirements from our joint venture partner, JSR, and from alternative suppliers as needed. In Brazil, isoprene is primarily obtained from local third party suppliers under short term contractual arrangements. These suppliers may not be able to meet our isoprene requirements, and we may not be able to obtain isoprene in quantities required for our operations on terms favorable to us, or at all. A lack of availability of isoprene in the quantities we require to produce products containing isoprene could have a material adverse effect on our results of operations.

Because there is limited non-captive isoprene availability, the market for isoprene is thin and prices are particularly volatile. Prices for isoprene are impacted by the supply and prices of natural and synthetic rubber, prevailing energy prices and the existing supply and demand of isoprene in the market. In the past, tight supply in the isoprene market has been exacerbated by operational problems of some key producers and reduced availability of crude C5 inputs for the extraction units. More recently, the trend toward lighter ethylene cracker feed slates has reduced the supply of crude C5 in the United States. This decrease has been replaced by imports of crude C5 and/or isoprene. Significant increases in the cost of isoprene could have a material adverse impact on our results of operations, financial condition and cash flows.

If the availability of butadiene is limited, we may be unable to produce some of our products in quantities or on economic terms sought by our customers, which could have an adverse effect on our sales of products requiring butadiene.

The North American market is structurally short of butadiene and has relied on imports of crude C4 and/or butadiene to balance demand. With the trend toward lighter ethylene cracker feed slates in the United States, there has been a reduction in the supply of crude C4. The North American market has been supplemented by imports of crude C4 and butadiene. Historically, the European market has been better balanced and provided exports to North America.

Currently, our butadiene requirements in the United States are satisfied by several suppliers, and LyondellBasell is our major butadiene supplier in Europe. In general, the quantity of butadiene available in any one region is dependent on the cracking inputs of olefins plants, ethylene demand, inter-regional demand for butadiene and demand for other oil derivatives. Suppliers may not be able to meet our butadiene requirements, and we may not be able to obtain substitute supplies of butadiene from alternative suppliers in a timely manner or on favorable terms. A lack of availability of butadiene in the quantities we require to produce products containing butadiene could have a material adverse effect on our results of operations, financial condition and cash flows.

If the availability of styrene is limited, we may be unable to produce some of our products in quantities or on economic terms sought by our customers, which could have an adverse effect on facility utilization and our sales of products requiring styrene.

We satisfy our styrene requirements in the United States and Europe pursuant to purchase agreements with terms of one to two years, subject to renewal conditions. We have more than one supplier in each of these regions and also generally have alternatives for either modifying the contract, supply portfolio or obtaining spot supply. 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 consequently our future acquisition costs for styrene may therefore increase which could have a material adverse effect on our results of operations, financial condition and cash flows.

If the availability of CTO is limited, we may be unable to produce some of our products in quantities or on economic terms sought by our customers, which could have an adverse effect on facility utilization and the sales of products requiring CTO.

The availability of CTO is directly linked to the production output of kraft mills using pine as their source of pulp. As a result, there is a finite global supply of CTO, with global demand for kraft board driving the global supply of CTO, rather than demand for CTO itself. Most of the CTO made available for sale by its producers in North America is covered by long-term supply agreements, further constraining availability. We have a long-term supply contract with International Paper pursuant to which they sell to us all of the CTO produced at their paper mills. If International Paper, or any of our other suppliers for CTO, fail to meet their respective obligations under supply agreements or if we are otherwise unable to procure an adequate supply of CTO, we may be unable to produce the quantity of products needed to satisfy customer demand. There are other pressures on the availability of CTO. Some pulp or paper mills may choose to consume their production of CTO to meet their energy needs rather than sell the CTO to third parties. Also, there are regulatory pressures that may incentivize suppliers of CTO to sell CTO into alternative fuel markets rather than to historical end users. Furthermore, weather conditions have in the past and may in the future affect the availability and quality of pine trees used in the kraft pulping process and therefore the availability of CTO meeting our quality standards. A lack of availability of CTO in the quantities we require to produce products containing CTO could have a material adverse effect on our results of operations, financial condition and cash flows.

The European Union's Directive 2009/28 on the promotion of the use of energy from renewable resources ("Renewable Energy Directive" or "RED") and similar legislation in the United States and elsewhere may incentivize the use of CTO as a feedstock for production of alternative fuels.

In December 2008, the European Union adopted RED, which established a 20% EU-wide target for energy consumed from renewable sources relative to the EU's gross final consumption of energy, as well as a 10% target for energy consumed from renewable sources in the transport section by 2020. In order to reach these targets, the RED established mandatory targets for each Member State (as defined in RED) and required each Member State to adopt a national renewable energy action plan setting forth measures to achieve its national targets. RED also established sustainability criteria for biofuels, which must be satisfied in order for the consumption of a fuel to count toward a Member State's national targets. CTO-based biofuel currently fulfills RED's biofuel sustainability criteria. In spring 2015, the EU adopted amendments to RED, expressly listing CTO as a residue- type feedstock whose use in biofuel would make that biofuel eligible for double counting towards national targets of the Member States, and at least two Member States additionally have or plan fiscal incentives for the domestic marketing of CTO-based and other qualifying biofuels. In addition to these developments in the European Union, various pieces of legislation regarding the use of alternative fuels have been introduced in the United States. Because the supply of CTO is inherently constrained by the volume of kraft pulp processing, any diversion of CTO for production of alternative fuels would reduce the available supply of CTO as the principal raw material of the pine chemicals industry. A reduced ability to procure an adequate supply of CTO due to competing new uses such as for biofuel production, could have a material adverse effect on our results of operations, financial condition and cash flows.

Increases in the costs of our raw materials could have an adverse effect on our financial condition and results of operations if those costs cannot be passed onto our customers.

Our results of operations are directly affected by the cost of raw materials. We use butadiene, styrene, and isoprene as our primary raw materials in our SBC Business. On a first-in, first-out (FIFO) basis, these monomers together represented approximately $385.2 million, $512.8 million and $609.5 million or 47.8%, 51.6% and 57.2% of our total cost of goods sold for the years ended December 31, 2015, 2014 and 2013, respectively. In connection with the Arizona Chemical Acquisition, CTO has become another one of our primary raw materials. Since the cost of these primary raw materials comprise a significant amount of our total cost of goods sold, the selling prices for our products and therefore our total revenue is impacted by movements in these raw material costs, as well as the cost of other inputs. In the past we have experienced erratic and significant changes in the costs of these raw materials, the cost of which has generally correlated with changes in energy prices, supply and demand factors, and prices for natural and synthetic rubber. The pricing for butadiene has historically been particularly volatile. Political unrest in the Middle East and market dislocation resulting from U.S. sanctions relating thereto could lead to increases in the price of crude oil, and, as a result, in the price of butadiene, styrene and isoprene. In addition, product mix can have an impact on our overall unit selling prices, since we provide an extensive product offering and therefore experience a wide range of unit selling prices. Because of the significant portion of our cost of goods sold represented by these raw materials, our gross profit margins could be adversely affected by changes in the cost of these raw materials if we are unable to pass the increases on to our customers.

Due to volatile raw material price increases, there can be no assurance that we can continue to recover raw material costs or retain customers in the future. As a result of our pricing actions, customers may become more likely to consider competitors' products, some of which may be available at a lower cost. Significant loss of customers could result in a material adverse effect on our results of operations, financial condition and cash flows.

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

In periods of raw material price volatility, reported results under GAAP will differ from what the results would have been if cost of goods sold were based on estimated current replacement cost ("ECRC"). Specifically, in periods of declining raw material costs, reported gross profit will be lower under GAAP than under ECRC, and in periods of rising raw material costs, gross profit will be higher under GAAP than under ECRC. However, because raw material costs are difficult to predict, we cannot accurately anticipate fluctuations in monomer costs with precision, or effectively or economically hedge against the effects of any such change. If monomer costs fluctuate in a quarter, our results of operations will be affected, the magnitude of which could be significant, which could cause our earnings to depart from the periodic expectations of financial analysts or investors and, therefore, the market price of our common stock may be volatile as a result.

LyondellBasell Industries provides significant operating and other services under agreements that are important to our business. The failure of LyondellBasell to perform its obligations, or the termination of these agreements, could adversely affect our operations.

We have operating and service agreements with LyondellBasell Industries, or LyondellBasell, that are important to our business. We are a party to:

- operating agreements under which LyondellBasell (in Berre, France, and Wesseling, Germany) operates and maintains our European manufacturing facilities and employs and provides substantially all of the staff for those facilities; these operating agreements also provide for site services, utilities, materials and facilities, which had previously been under separate agreements; and
- lease agreements under which we lease our European manufacturing sites for our Polymers Business (a 96 kiloton capacity facility in Wesseling, Germany and an 85 kiloton capacity facility in Berre, France) from LyondellBasell.

Under the terms of the above agreements, either party is permitted to terminate the applicable agreement in a variety of situations. The operating agreement for our Berre facility has an unlimited term, but is terminable as of any date after December 31, 2020 following a minimum 18 months notice by either party. As of the date of this filing, no such notice has been given by either party. Should LyondellBasell fail to provide these services or should any operating agreement be terminated, we would be forced to obtain these services from third parties or provide them ourselves. Similarly, if in connection with or independent from the termination of an operating agreement, LyondellBasell terminates a facility lease, we would be forced to relocate our manufacturing facility. The failure of LyondellBasell to perform its obligations under, or the termination of, any of these agreements could materially adversely affect our operations and, depending on market conditions at the time of any such termination, we may not be able to enter into substitute arrangements in a timely manner, if at all, and if we are able to enter into a substitute arrangement, it may not be on terms as favorable to us.

Our industry is highly competitive, and we may lose market share to other producers of SBCs, pine based specialty chemicals or other products that can be substituted for our products.

Our industry is highly competitive, and we face significant competition from both large international producers and from smaller regional competitors. Our competitors may improve their competitive position in our core markets by successfully introducing new products, improving their manufacturing processes, or expanding their capacity or manufacturing facilities. Further, some of our competitors benefit from advantageous cost positions that could make it increasingly difficult for us to compete in markets for less-differentiated applications. If we are unable to keep pace with our competitors' product and manufacturing process innovations or cost position, it could have a material adverse effect on our results of operations, financial condition and cash flows.

In addition, competition in the various product applications in which we compete is intense. Increased competition from existing or newly developed SBCs, pine-based specialty chemicals or other products may reduce demand for our products in the future and our customers may decide on alternate sources to meet their requirements. If we are unable to successfully compete with other producers of SBCs or refiners of CTO, or if other products can be successfully substituted for our products, our sales may decline. Our tall oil-based resins compete against hydrocarbon and gum-based resins in the adhesives and inks submarkets, and our TOFA competes against animal and vegetable-based fatty acids. We could be subject to pricing pressure from Chinese manufacturers of gum rosins, and hydrocarbon competitors have introduced metallocene-based products that compete directly with many of our adhesive tackifiers.

If we are not able to continue the technological innovation and successful commercial introduction of new products, our customers may turn to other producers to meet their requirements.

Our industry and the markets into which we sell our products experience periodic technological change and ongoing product improvements. In addition, our customers may introduce new generations of their own products or require new technological and increased performance specifications that would require us to develop customized products. Innovation or other changes in our customers' product performance requirements may also adversely affect the demand for our products. Our future growth and profitability will depend on our ability to gauge the direction of the commercial and technological progress in all key markets, and upon our ability to successfully develop, manufacture and sell products in such changing markets. In order to maintain our profit margins and our competitive position, we must continue to identify, develop and market innovative products on a timely basis to replace existing products. We may not be successful in developing new products and technology that successfully compete with newly introduced products and materials, and our customers may not accept, or may have lower demand for, any of our new products. Further, an important part of our strategy is the creation of demand for innovations that we develop and introduce to the markets. If we fail to keep pace with evolving technological innovations, fail to modify our products in response to our customers' needs or fail to develop innovations that generate additional demand, then our business, financial condition and results of operations could be adversely affected as a result of reduced sales of our products or diminished return on investment in innovations.

Our business relies on intellectual property and other proprietary information, and our failure to protect our rights could harm our competitive advantages with respect to the manufacturing of some of our products.

Our success depends, to a significant degree, upon our ability to protect and preserve our intellectual property and other proprietary information relating to our business. However, we may be unable to prevent third parties from using our intellectual property and other proprietary information without our authorization or from independently developing intellectual property and other proprietary information that is similar to ours, particularly in those countries where the laws do not protect our proprietary rights to the same degree as in the United States. The use of our intellectual property and other proprietary information by others could reduce or eliminate any competitive advantage we have developed, potentially causing us to lose sales or otherwise harm our business. If it becomes necessary for us to litigate to protect these rights, any proceedings could be burdensome and costly, and we may not prevail.

In addition, we acquired a significant number of patents from Shell Chemicals. According to the agreements with Shell Chemicals relating to their contribution of these patents to us and our ownership of these patents, Shell Chemicals retained for itself fully-transferable and exclusive licenses to their use outside of the elastomers business, as well as fully-transferable non-exclusive licenses within the field of elastomers for certain limited uses in non-competing activities. Shell Chemicals is permitted to sublicense these rights. Shell Chemicals also retains the right to enforce these patents outside the elastomers field and recover any damages resulting from these actions.

Our patent applications and issued patents may not provide us with any competitive advantage and may be challenged by third parties. Our competitors may also attempt to design around our patents or copy or otherwise obtain and use our intellectual property and other proprietary information. Moreover, our competitors may already hold or have applied for patents in the United States or abroad that, if enforced or issued, could possibly prevail over our patent rights or otherwise limit our ability to manufacture or sell one or more of our products in the United States or abroad. With respect to our pending patent applications, we may not be successful in securing patents for these claims. Our failure to secure these patents may limit our ability to protect inventions that these applications were intended to cover. In addition, the expiration of a patent can result in increased competition with consequent erosion of profit margins.

It is our policy to enter into confidentiality agreements with our employees and third parties to protect our unpatented proprietary manufacturing expertise, continuing technological innovation and other trade secrets, but our confidentiality agreements could be breached or may not provide meaningful protection for our trade secrets or proprietary manufacturing expertise. Adequate remedies may not be available in the event of an unauthorized use or disclosure of our trade secrets and manufacturing expertise. Violations by others of our confidentiality agreements and the loss of employees who have specialized knowledge and expertise could harm our competitive position and cause our sales and operating results to decline as a result of increased competition. In addition, others may obtain knowledge of our trade secrets through independent development or other access by legal means.

The applicable governmental authorities may not approve our pending service mark and trademark applications. A failure to obtain trademark registrations in the United States and in other countries could limit our ability to obtain and retain our trademarks and impede our marketing efforts in those jurisdictions. Moreover, third parties may seek to oppose our applications or otherwise challenge the resulting registrations. In the event that our trademarks are successfully challenged, we could be forced to rebrand our products, which could result in loss of brand recognition and could require us to devote resources to advertising and marketing new brands.

The failure of our patents, trademarks or confidentiality agreements to protect our intellectual property and other proprietary information, including our processes, apparatuses, technology, trade secrets, trade names and proprietary manufacturing expertise, methods and compounds, could have a material adverse effect on our competitive advantages over other producers.

Our products may infringe on the intellectual property rights of others, which may cause us to incur unexpected costs or prevent us from selling our products.

Many of our competitors have a substantial amount of intellectual property. We cannot guarantee that our processes and products do not and will not infringe issued patents (whether present or future) or other intellectual property rights belonging to others, including, without limitation, situations in which our products, processes or technologies may be covered by patent applications filed by other parties in the United States or abroad.

From time to time, we oppose patent applications that we consider overbroad or otherwise invalid in order to maintain the necessary freedom to operate fully in our various business lines without the risk of being sued for patent infringement. If, however, patents are subsequently issued on any such applications by other parties, or if patents belonging to others already exist that cover our products, processes or technologies, we could be liable for infringement or have to take other remedial or curative actions to continue our manufacturing and sales activities with respect to one or more products.

We may also be subject to legal proceedings and claims in the ordinary course of our business, including claims of alleged infringement of the patents, trademarks and other intellectual property rights of third parties by us or our licensees in connection with their use of our products. Intellectual property litigation is expensive and time-consuming, regardless of the merits of any claim, and could divert our management’s attention from operating our business.

If we were to discover that our processes, technologies or products infringe the valid intellectual property rights of others, we might need to obtain licenses from these parties or substantially re-engineer our products in order to avoid infringement. We may not be able to obtain the necessary licenses on acceptable terms, or at all, or be able to re-engineer our products successfully. Moreover, if we are sued for infringement and lose, we could be required to pay substantial damages and/or be enjoined from using or selling the infringing products or technology. If we incur significant costs to litigate our intellectual property rights or to obtain licenses, or if our inability to obtain required licenses for our processes, technologies or products prevents us from selling our products, it could have a material adverse effect on our business and results of operations.

A major failure of our information systems could harm our business.

We depend on integrated information systems to conduct our business. We may experience operating problems with our information systems as a result of system failures, viruses, computer “hackers” or other causes. If our systems for protecting against these risks prove not to be sufficient, we could be adversely affected by, among other things, loss or damage of intellectual property, proprietary information, or customer data, having our business operations interrupted, and increased costs to prevent, respond to, or mitigate attacks on our systems. Any significant disruption or slowdown of our systems could cause customers to cancel orders or cause standard business processes to become inefficient or ineffective, which could adversely affect our results of operations, financial position or cash flows. Additionally, in connection with the Arizona Chemical Acquisition, integration activities for our separate ERP systems will begin in 2016. Disruption to the integration process could affect functionality, which could affect the conduct of our business.

Our business is subject to seasonality that may affect our quarterly operating results and impact the market price of our common stock.

Seasonal changes and weather conditions typically affect our sales in our paving (including roadmarkings), roofing and construction applications. In particular, sales volumes generally rise in the warmer months and generally decline during the colder months of fall and winter, or during abnormally wet seasons. In addition, sales into the ink submarket are typically highest in the third quarter of the year due to increased demand for holiday catalog printing. However, because seasonal weather patterns are difficult to predict, we cannot accurately estimate quarterly fluctuations in sales into our paving, roofing, construction, and ink submarkets in any given year.

Seasonality also affects the availability of CTO and CST, two of our primary raw materials. Yields of CTO and CST are higher during the first half of the year, generally peaking during the early summer months, due to the natural growth and associated chemical yield cycles of trees, in addition to higher yields from kraft pulping during the cooler months.

Chemical manufacturing is inherently hazardous, which could result in accidents that disrupt our operations or expose us to significant losses or liabilities.

Hazards associated with chemical manufacturing and the related storage and transportation of raw materials, products and wastes exist in our operations and the operations of other occupants with whom we share manufacturing sites. These hazards could lead to an interruption or suspension of operations and have an adverse effect on the productivity and profitability of a particular manufacturing facility or on us as a whole. These potential risks include, but are not necessarily limited to:

- pipeline and storage tank leaks and ruptures;
- explosions and fires;

- inclement weather and natural disasters;
- terrorist attacks;
- mechanical failure; and
- chemical spills and other discharges or releases of toxic or hazardous substances or gases.

These hazards may result in personal injury and loss of life, damage to property and contamination of the environment, which may result in a suspension of operations and the imposition of civil or criminal penalties, including governmental fines, expenses for remediation and claims brought by governmental entities or third parties. The loss or shutdown of operations over an extended period at any of our major operating facilities could have a material adverse effect on our financial condition and results of operations. Our property, business interruption and casualty insurance may not fully insure us against all potential hazards incidental to our business.

We may be liable for damages based on product liability claims brought against our customers.

Many of our products provide critical performance attributes to our customers' products that are sold to consumers who could potentially bring product liability suits in which we could be named as a defendant. For example, certain of the chemicals or substances that are used in our businesses, including alkyl phenols such as bisphenol A and nonylphenol, flammable solvents such as toluene, xylene and alcohols, and rosin, formaldehyde and resin dust, have been identified as having potentially harmful health effects. The sale of these products entails the risk of product liability claims. If a person were to bring a product liability suit against one of our customers, the customer may attempt to seek contribution from us. A person may also bring a product liability claim directly against us. A successful product liability claim or series of claims against us in excess of our insurance coverage, for which we are not otherwise indemnified, could have a material adverse effect on our financial condition or results of operations. There can be no assurance that our efforts to protect ourselves from product liability claims in this regard will ultimately protect us from any such claims.

As a global business, we are exposed to local business risks in different countries, which could have a material adverse effect on our financial condition or results of operations.

We have significant operations in foreign countries, including manufacturing facilities, research and development facilities, sales personnel and customer support operations. Currently, we operate, or others operate on our behalf, facilities in Brazil, Finland, France, Germany, Japan and Sweden, in addition to our operations in the United States. Furthermore, we are a 50/50 joint venture partner with FPCC to build, own and operate a 30 kiloton HSBC plant at FPCC's petrochemical site in Mailiao, Taiwan.

Our foreign operations are subject to risks inherent in doing business in foreign countries, including, but not necessarily limited to:

- new and different legal and regulatory requirements in local jurisdictions;
- export duties or import quotas;
- domestic and foreign customs and tariffs or other trade barriers;
- potential staffing difficulties and labor disputes;
- risk of non-compliance with the United States Foreign Corrupt Practices Act or similar anti-bribery legislation in other countries by agents or other third-party representatives;
- managing and obtaining support and distribution for local operations;
- increased costs of transportation or shipping;
- credit risk and financial conditions of local customers and distributors;
- potential difficulties in protecting intellectual property;
- risk of nationalization of private enterprises by foreign governments;
- potential imposition of restrictions on investments;
- potentially adverse tax consequences, including imposition or increase of withholding and other taxes on remittances and other payments by subsidiaries;
- foreign currency exchange restrictions and fluctuations;
- local political and social conditions, including the possibility of hyperinflationary conditions and political instability in certain countries; and
- civil unrest, including labor unrest, in response to local political conditions.

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We may not be successful in developing and implementing policies and strategies to address the foregoing risks in a timely and effective manner at each location where we do business. Consequently, the occurrence of one or more of the foregoing risks could have a material adverse effect on our international operations or upon our financial condition and results of operations.

Compliance with extensive environmental, health and safety laws could require material expenditures, changes in our operations or site remediation.

The manufacturing of our products can present potentially significant health and safety concerns. Our products are also used in a variety of applications that have specific regulatory requirements such as those relating to products that have contact with food or are used for medical applications.

We use large quantities of hazardous substances and generate hazardous wastes in our manufacturing operations. Consequently, our operations are subject to extensive environmental, health and safety laws and regulations at the international, national, state and local level in multiple jurisdictions. These laws and regulations govern, among other things, air emissions, wastewater discharges, solid and hazardous waste management, site remediation programs and chemical use and management. Many of these laws and regulations have become more stringent over time and the costs of compliance with these requirements may increase, including costs associated with any necessary capital investments. In addition, our production facilities require operating permits that are subject to renewal and, in some circumstances, revocation. The necessary permits may not be issued or continue in effect, and renewals of any issued permits may contain significant new requirements or restrictions. The nature of the chemical industry exposes us to risks of liability due to the use, production, management, storage, transportation and sale of materials that are heavily regulated or hazardous and can cause contamination or personal injury or damage if released into the environment.

Because of the nature of our operations, we could be subject to legislation and regulation affecting the emission of greenhouse gases. In the last five years, the U.S. Environmental Protection Agency (“EPA”) promulgated regulations applicable to projects involving greenhouse gas emissions above a certain threshold, and the U.S. and certain states within the U.S. have enacted, or are considering, limitations on greenhouse gas emissions.

Jurisdictions outside the U.S. are also addressing greenhouse gases by legislation or regulation. In addition, efforts have been made and continue to be made at the international level toward the adoption of international treaties or protocols that would address global greenhouse gas emissions. These requirements to limit greenhouse gas emissions may require us to incur capital investments to upgrade our operations to comply with any future greenhouse gas emissions controls. While the impact of any such legislation, regulation, treaties or protocols is currently speculative, any such legislation, regulation, treaties or protocols, if enacted, may have an adverse effect on our operations or financial condition. Further, some scientific studies on the effect of the emission of greenhouse gases on climate suggest that adverse weather events may become stronger or more frequent in the future in certain of the areas in which we operate, although the scientific studies are not unanimous. Due to their location, some of our operations may be vulnerable to operational and structural damages resulting from hurricanes and other severe weather systems. Our insurance may not cover all associated losses. We are taking steps to mitigate physical risks from storms, but no assurance can be given that future storms will not have a material adverse effect on our business.

Compliance with environmental laws and regulations generally increases the costs of transportation and storage of raw materials and finished products, as well as the costs of storage and disposal of wastes. We may incur substantial costs, including fines, damages, criminal or civil sanctions and remediation costs, or experience interruptions in our operations for violations arising under environmental laws, regulations or permit requirements.

Regulation of our employees’ exposure to certain chemicals could require material expenditures or changes in our operations.

The Occupational Safety and Health Act (“OSHA”) in the United States and the Registration, Evaluation and Authorization of Chemicals (“REACH”), directive in Europe, prescribe limitations restricting exposure to a number of chemicals used in our operations, including butadiene, formaldehyde and nonylphenol, a raw material used in the manufacture of phenolic ink resins. Butadiene is a known carcinogen in laboratory animals at high doses and is being studied for its potential adverse health effects. Future studies on the health effects of these, and other, chemicals may result in additional regulations or new regulations that further restrict or prohibit the use of, and exposure to, such chemicals. Additional regulation of or requirements for these chemicals could require us to change our operations, and these changes could affect the quality of our products and materially increase our costs.

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We may be subject to losses due to lawsuits arising out of environmental damage or personal injuries associated with chemical manufacturing.

We face the risk that individuals could, in the future, seek damages for personal injury due to exposure to chemicals at our facilities or to chemicals otherwise owned or controlled by us. We may be subject to future claims with respect to workplace exposure, workers' compensation and other matters that are filed after the date of our acquisition of Shell Chemicals' elastomers business. While Shell Chemicals has agreed to indemnify us for certain claims brought with respect to matters occurring before our separation from Shell Chemicals in February 2001, those indemnity obligations are subject to limitations, and we cannot be certain that those indemnities will be sufficient to satisfy claims against us. In addition, we face the risk that future claims would fall outside of the scope of the indemnity due either to the limitations on the indemnity or to their arising from events and circumstances occurring after February 2001. Finally, under certain of the lease and operating agreements under which LyondellBasell leases and provides services to our sites in Wesseling, Germany, and Berre, France, we are required to indemnify LyondellBasell in certain circumstances, including in certain circumstances for loss and damages resulting from LyondellBasell's negligence in performing their obligations.

Some environmental laws could impose on us the entire cost of clean-up of contamination present at a facility even though we did not cause the contamination. These laws often identify the site owner as one of the parties that can be jointly and severally liable for on-site remediation, regardless of fault or whether the original activity was legal at the time it occurred. For example, our Belpre, Ohio, facility is the subject of a required remediation program to clean up past contamination at the site and at an adjacent creek and we are a party to that site clean-up order. While Shell Chemicals has posted financial assurance of $5.2 million for this program and has taken the lead in implementing the program, we may incur costs and be required to take action under this program. Similarly, the Shell Chemicals indemnity for remediation at the Belpre facility may not cover all claims that might be brought against us.

Our Paulinia, Brazil, facility also has on-site contamination resulting from past operations of Shell Chemicals. Although an indemnity from Shell Chemicals covers claims related to specified areas within the facility, we may be required to undertake and pay for remediation of these and other areas. The indemnity coverage from Shell Chemicals is limited in time and amount and we cannot rely upon it to cover possible future claims for on-site contamination separate from the areas specified in the indemnity. The Paulinia facility is also adjacent to a former Shell Chemicals site where we believe past manufacturing of hydrocarbons resulted in significant contamination of soil and groundwater and required relocation of nearby residents. It is our understanding that the Shell Chemicals portion of the site has changed ownership several times, which may impact financial responsibility for contamination on the site. While we are not aware of any significant contamination at our Paulinia facility, we could potentially be the subject of claims related to pesticide contamination and effects at some point in the future.

With respect to the Arizona Chemical Acquisition, International Paper provided an indemnification to the buyer with the divestiture of Arizona Chemical in February 2007. This indemnity covered specific known environmental liabilities and other environmental liabilities pertaining to former properties. At the closing of the Arizona Chemical Acquisition, Kraton was assigned the right to International Paper's indemnity for such environmental liabilities and assumed certain related obligations. Certain liabilities may fall outside the scope of the indemnity and therefore we cannot be certain that the indemnity will be sufficient to satisfy all environmental liabilities of Arizona Chemical.

In general, there is always the possibility that a third-party plaintiff or claimant, or governmental or regulatory authority, could seek to include us in an action or claim for damages, clean-up, or remediation pertaining to events or circumstances occurring or existing at one or more of our sites prior to the time of our ownership or occupation of the applicable site. In the event that any of these actions or claims were asserted against us, our results of operations could be adversely affected.

We are subject to 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.

We are subject to numerous regulations, including customs and international trade laws, export control, antitrust laws and zoning and occupancy laws that regulate manufacturers generally and/or govern the importation, promotion and sale of our products, the operation of factories and warehouse facilities and our relationship with our customers, suppliers and competitors. If these regulations were to change or were violated by our management, employees, suppliers, buying agents or trading companies, the costs of certain goods could increase, or we could experience delays in shipments of our goods, be subject to fines or penalties, or suffer reputational harm, which could reduce demand for our products and hurt our business and negatively impact our results of operations. In addition, changes in federal and state minimum wage laws and other laws relating to employee benefits could cause us to incur additional wage and benefits costs, which could negatively impact our profitability.

Legal requirements are frequently changed and subject to interpretation, and we are unable to predict the ultimate cost of compliance with these requirements or their effects on our operations. We may be required to make significant expenditures or modify our business practices to comply with existing or future laws and regulations, which may increase our costs and materially limit our ability to operate our business.

Fluctuations in currency exchange rates may significantly impact our results of operations and may significantly affect the comparability of our results between financial periods.

Our operations are conducted by our subsidiaries in many countries. The results of the operations and the financial position of these subsidiaries are reported in the relevant foreign currencies and then translated into U.S. dollars at the applicable exchange rates for inclusion in our consolidated financial statements. The main currencies to which we are exposed, besides the U.S. dollar, are the Euro, Japanese Yen, Brazilian Real, and Swedish Krona. The exchange rates between these currencies and the U.S. dollar in recent years have fluctuated significantly and may continue to do so in the future. A depreciation of these currencies against the U.S. dollar will decrease the U.S. dollar equivalent of the amounts derived from these operations reported in our consolidated financial statements and an appreciation of these currencies will result in a corresponding increase in such amounts. Because many of our raw material costs are determined with respect to the U.S. dollar rather than these currencies, depreciation of these currencies may have an adverse effect on our profit margins or our reported results of operations. Conversely, to the extent that we are required to pay for goods or services in foreign currencies, the appreciation of such currencies against the U.S. dollar will tend to negatively impact our results of operations. In addition, currency fluctuations may affect the comparability of our results of operations between financial periods.

We incur currency transaction risk whenever we enter into either a purchase or sale transaction using a currency other than the local currency of the transacting entity. From time to time, we use hedging strategies to reduce our exposure to currency fluctuations. Given the volatility of exchange rates, there can be no assurance that we will be able to effectively manage our currency transaction risks, that our hedging activities will be effective or that any volatility in currency exchange rates will not have a material adverse effect on our financial condition or results of operations.

We may have additional tax liabilities.

We are subject to income taxes and state taxes in the U.S., as well as numerous foreign jurisdictions. Significant judgment is required in determining our worldwide provision for income taxes. In the ordinary course of our business, there are many transactions and calculations where the ultimate tax determination is uncertain. Although we believe our tax estimates are reasonable, the final determination of tax audits and any related litigation could be materially different to that which is reflected in our consolidated financial statements. Should any tax authority take issue with our estimates, our results of operations, financial position and cash flows could be adversely affected.

Our formation of a joint venture to expand HSBC capacity in Asia is subject to risks and uncertainties.

We are a 50/50 joint venture partner with FPCC to build, own and operate a 30 kiloton HSBC plant at FPCC’s petrochemical site in Mailiao, Taiwan. Construction of the HSBC plant is ongoing; however, the plant may not be successfully constructed and operated within our expected timeframe or budget or yield expected results. In addition, the project remains subject to numerous known and unknown contingencies, including material governmental approvals and permitting; cost and availability of raw materials, labor and financing; weather and operational delays; and economic, political and other disruptions. If any of these risks materialize, it could have a material adverse effect on our prospects in Asia and our ability to meet demand for HSBC products.

In January 2014, a group of local residents in Mailiao, Taiwan, sued the Taiwanese Executive Yuan (the executive branch of the Taiwanese government) to overturn an appeal decision rendered by the Executive Yuan in which it had overturned a prior ruling of the Taiwan Environmental Protection Administration. The Taiwan EPA ruling in question required the inclusion of restrictive conditions relating to FPCC’s entire petrochemical site in Mailiao, Taiwan, which is the site of our joint venture with FPCC, in the environmental permit for the construction of the HSBC plant by our joint venture company. Neither we nor our joint venture is a party to the proceedings, nor do we or our joint venture have any right under Taiwan law to join the proceedings. The court in the proceeding has issued a ruling that could reinstate the restrictive conditions in FPCC’s environmental permit. The Executive Yuan and FPCC have appealed the ruling. The ruling conflicts with the prior appeal decision of the Executive Yuan, and if the ruling is not overturned, it could adversely impact the ability of the joint venture to obtain material operating permits in the future.

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Our relationship with our employees could deteriorate, which could adversely affect our operations.

As a manufacturing company, we rely on our employees and good relations with our employees to produce our products and maintain our production processes and productivity. A significant number of our non-U.S. employees are subject to arrangements similar to collective bargaining arrangements. Following the Arizona Chemical Acquisition, we had approximately 23.4% of our combined United States employees represented by unions. In addition, a collective bargaining agreement at the Savannah, Georgia manufacturing facility is currently under negotiation. We may not be able to negotiate existing or future arrangements on satisfactory terms or at all, which may adversely affect our business. If these workers were to engage in a strike, work stoppage or other slowdown, our operations could be disrupted or we could experience higher labor costs, which could adversely affect our business, results of operations, cash flows and financial condition.

In addition, if our other employees were to become unionized, in particular our employees at our Belpre, Ohio, facility, we could experience significant operating disruptions and higher ongoing labor costs, which could adversely affect our business and financial condition and results of operations. Because many of the personnel who operate our European facilities are employees of LyondellBasell, relations between LyondellBasell and its employees may also adversely affect our business, results of operations, cash flows and financial condition.

Loss of key personnel or our inability to attract and retain new qualified personnel could hurt our business and inhibit our ability to operate and grow successfully.

Our success in the highly competitive markets in which we operate will continue to depend to a significant extent on our key employees. We are dependent on the expertise of our executive officers. Loss of the services of any of our executive officers could have an adverse effect on our prospects. We may not be able to retain our key employees or to recruit qualified individuals to join our company. The loss of key employees could result in high transition costs and could disrupt our operations.

We generally do not have long-term contracts with our customers and the loss of customers could adversely affect our sales and profitability.

With some exceptions, our business is based primarily upon individual sales orders with our customers. As such, our customers could cease buying our products from us at any time, for any reason, with little or no recourse. If multiple customers elected not to purchase products from us, our business prospects, financial condition and results of operations could be adversely affected.

A decrease in the fair value of pension assets could materially increase future funding requirements of the pension plans.

We sponsor defined benefit pension plans. The total projected benefit obligation of our defined benefit pension plan exceeded the fair value of the plan assets by approximately $55.0 million at December 31, 2015. We contributed $1.8 million to the pension plan in 2015. In connection with the Arizona Chemical Acquisition on January 6, 2016, we assumed responsibility for several additional international pension plans and one additional U.S defined benefit pension plan. The total projected benefit obligation of these additional international and U.S. pension plans exceeded the fair value of plan assets by approximately $28.7 million and $4.9 million as of December 31, 2015. Among the key assumptions inherent in the actuarially calculated pension plan obligation and pension plan expense are the discount rate and the expected rate of return on plan assets. If discount rates or actual rates of return on invested plan assets were to decrease, the pension plan obligation could increase materially. The size of future required pension contributions could result in our dedicating a substantial portion of our cash flow from operations to making the contributions, which could materially adversely affect our business, financial condition and results of operations.

Domestic or international natural disasters or terrorist attacks may disrupt our operations, decrease the demand for our products or otherwise have an adverse impact on our business.

Chemical related assets, and U.S. corporations such as ours, may be at a greater risk of future terrorist attacks than other possible targets in the U.S. and throughout the world. Moreover, extraordinary events such as natural disasters may negatively affect local economies, including those of our customers or suppliers. The occurrence of such events cannot be predicted, although they can be expected to continue to adversely impact the economy in general and our specific markets. The resulting damage from such an event could include loss of life, property damage or site closure. Any, or a combination, of these factors could adversely impact our results of operations, financial position and cash flows.

Delaware law and certain provisions of our organizational documents may make a takeover of our company more difficult.

Provisions of our charter and bylaws may have the effect of delaying, deferring or preventing a change in control of our company. A change of control could be proposed in the form of a tender offer or takeover proposal that might result in a premium over the market price for our common stock. In addition, these provisions could make it more difficult to bring about a change in the composition of our board of directors, which could result in entrenchment of current management. For example, our charter and bylaws:

- establish a classified board of directors so that not all members of our board of directors are elected at one time;
- require that the number of directors be determined, and provide that any vacancy or new board seat may be filled, only by the board;
- do not permit stockholders to act by written consent;
- do not permit stockholders to call a special meeting;
- permit the bylaws to be amended by a majority of the board without shareholder approval, and require that a bylaw amendment proposed by stockholders be approved by two-thirds of all outstanding shares;
- establish advance notice requirements for nominations for elections to our board of directors or for proposing matters that can be acted upon by stockholders at stockholder meetings; and
- authorize the issuance of undesignated preferred stock, or "blank check" preferred stock, by our board of directors without shareholder approval.

Our Kraton Performance Polymers, Inc. Executive Severance Program and the equity arrangements with our executive officers also contain change in control provisions. Under the terms of these arrangements, the executive officers are entitled to receive significant cash payments, immediate vesting of options, restricted shares and notional shares, and continued medical benefits in the event their employment is terminated under certain circumstances within one year following a change in control, and with respect to certain equity awards, within two years following a change in control.

Any amounts accrued under the Kraton Polymers LLC Executive Deferred Compensation Plan are immediately payable upon a change of control. We disclose in proxy statements filed with the SEC potential payments to our named executive officers in connection with a change of control. Further, the terms of the indenture governing the 10.5% Senior Notes require us, upon certain change of control transactions, to repurchase our outstanding 10.5% Senior Notes at a price equal to 101.0% of their principal amount, plus any accrued and unpaid interest.

These arrangements and provisions of our organizational documents and Delaware law may have the effect of delaying, deferring or preventing changes of control or changes in management of our company, even if such transactions or changes would have significant benefits for our stockholders. As a result, these provisions could limit the price some investors might be willing to pay in the future for shares of our common stock.

We do not currently pay dividends and may not pay any dividends for the foreseeable future.

We do not currently pay dividends, and we may not pay dividends to our stockholders for the foreseeable future. The terms of the Term Loan Facility, the ABL Facility and the 10.5% Senior Notes limit our ability to pay cash dividends, and we may be subject to other restrictions on our ability to pay dividends from time to time. In addition, because we are a holding company, our ability to pay dividends depends on our receipt of cash dividends and distributions from our subsidiaries. Accordingly, investors must be prepared to rely on sales of their common stock after price appreciation to earn an investment return, which may never occur. Investors seeking cash dividends should not purchase our common stock. Any determination to pay dividends in the future will be made at the discretion of our board of directors and will depend upon our results of operations, financial condition, contractual restrictions, restrictions imposed by applicable law or the SEC and other factors that our board deems relevant.

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

Kraton Performance Polymers, Inc. is a holding company with nominal net worth. We do not have any assets or conduct any business operations other than our investments in our subsidiaries, including Kraton Polymers LLC. As a result, our ability to pay dividends, if any, will be dependent upon cash dividends and distributions or other transfers from our subsidiaries. Payments to us by our subsidiaries will be contingent upon their respective earnings and subject to any limitations on the ability of such entities to make payments or other distributions to us. In addition, our subsidiaries are separate and distinct legal entities and have no obligation to make any funds available to us.

Item 1B. Unresolved Staff Comments.
None.

Item 2. Properties.
Our principal executive offices are located at 15710 John F. Kennedy Boulevard, Suite 300, Houston, Texas 77032. We believe that our properties and equipment are generally in good operating condition and are adequate for our present needs. Production capacity at our sites can vary greatly depending upon feedstock, product mix and operating conditions. The following table sets forth our manufacturing facilities and principal products:
Polymers Business

Location	Principal Products	Annual Production Capacity (in kilotons)	Approximate Square Footage	Owned/Leased	
Belpre, Ohio	Performance Polymers, Specialty Products, Cariflex	175	3,600,000	Owned	(1)
Wesseling, Germany	Performance Polymers	96	354,000	Owned	(2)
Berre, France	Performance Polymers, Specialty Products	85	392,000	Owned	(2)
Paulinia, Brazil	Performance Polymers, Cariflex	28	2,220,000	Owned	
Kashima, Japan	Performance Polymers	31	395,000	Owned	(3)
Mailiao, Taiwan	Specialty Products	30	1,800,000	Leased	(4)

Arizona Chemical's Business

Location	Principal Products (Upgrades)	Annual CTO Refining Capacity (in kilotons)	Approximate Square Footage	Owned/Leased	
Panama City, Florida	Rosin Esters, Dispersions	107	217,626	Owned	
Pensacola, Florida	Terpene Resins	—	64,109	Owned	
Savannah, Georgia	Resin Esters, Resinates	213	186,125	Owned	(5)
Dover, Ohio	Dimer Acids, Polyamides	—	166,824	Owned	
Oulu, Finland	Rosin Esters and Soaps	156	167,681	Owned	(6)
Niort, France	AMS, Terpene Resins	—	187,405	Owned	
Sandarne, Sweden	Rosin Esters, Dispersions	174	378,892	Owned	
Gersthofen, Germany	Disprorosins	—	39,116	Owned	

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(1) The Belpre facility has approximately 175 kilotons of production capacity to which we are entitled. A portion of the HSBC capacity at the Belpre facility is owned by Infineum USA, a joint venture between Shell Chemicals and ExxonMobil that makes products for the lubricant additives business.

(2) Our Wesseling, Germany and Berre, France manufacturing facilities are located on LyondellBasell sites. We lease the land, but own the manufacturing facilities and production equipment. We have operating agreements with LyondellBasell for various site services, utilities, materials and facilities.

(3) The Kashima, Japan, manufacturing facility is owned and operated by a 50%-50% joint venture between us and JSR, named Kraton JSR Elastomers K.K. ("KJE"). We are generally entitled to 50% of this production pursuant to our joint venture agreement. JSR markets its portion of the production under its own trademarks, and we market our portion of the production under the Kraton® brand name although this amount may vary from time to time.

(4) The Mailiao, Taiwan facility is under construction by our 50%-50% KFPC joint venture with FPCC. The joint venture leases the land, but owns the manufacturing facility and production equipment. Construction of the plant is

ongoing with completion expected in 2016.

(5) We own our BLS acidulation manufacturing facility located in Savannah, Georgia. However, this manufacturing facility is located on land that we lease from International Paper. This lease expires on February 28, 2057.

(6) We own our manufacturing facility located in Oulu, Finland. However, this facility is located on land that we lease from Stora Enso Oy. This lease expires on August 31, 2046, with an option to extend the term until August 31, 2095.

Item 3. Legal Proceedings.

In connection with the closing of the Arizona Chemical Acquisition on January 6, 2016, we assumed responsibility for an open legal proceeding related to a claim from a former customer, Mohawk Industries, Inc. On March 21, 2011, Arizona Chemical received a claim from this former customer relating to an alleged breach of warranty and breach of contract regarding delivery of resin products during the period from 2005 through 2009. In March 2014, the jury returned a verdict against Arizona Chemical for $70.1 million. In addition, the trial court entered two separate judgments against Arizona Chemical in April 2015 for attorneys’ costs and interest totaling $18.9 million. Arizona Chemical has filed appeals with the Florida First District Court of Appeal to dispute all three judgments. These claims are covered by insurance and we expect the insurance company to reimburse us for the full amount of any judgments that are upheld on appeal.

In January 2014, our Belpre, Ohio facility experienced a mechanical equipment failure due to inclement weather that resulted in a release of process solvents into nearby waterways. Applicable authorities were notified, and cleanup activities are complete. Kraton may be required to pay governmental fines or sanctions in excess of $100,000 in connection with this event.

We and certain of our subsidiaries, from time to time, are parties to various other legal proceedings, claims, and disputes that have arisen in the ordinary course of business. These claims may involve significant amounts, some of which would not be covered by insurance. While the outcome of these proceedings cannot be predicted with certainty, our management does not expect any of these other existing matters, individually or in the aggregate, to have a material adverse effect upon our financial position, results of operations, or cash flows.

For information regarding legal proceedings, including environmental matters, see Note 12 Commitments and Contingencies (subsections (b) and (d) of which are incorporated herein by reference) to the consolidated financial statements for further discussion.

Item 4. Mine Safety Disclosures.

Not applicable.

PART II

Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.

Our common stock is listed on the New York Stock Exchange (NYSE) under the symbol "KRA". The following table sets forth the high and low intraday sales prices of our common stock per share, as reported by the NYSE.

	Stock Price Range	
	High	Low
2015		
Fourth Quarter	$23.53	$16.51
Third Quarter	$24.31	$16.97
Second Quarter	$25.22	$19.44
First Quarter	$21.35	$18.56
2014		
Fourth Quarter	$21.35	$15.52
Third Quarter	$22.62	$17.53
Second Quarter	$28.35	$21.23
First Quarter	$28.87	$20.91

We have not previously declared or paid any dividends or distributions on our common stock. As of February 22, 2016, we had approximately 95 shareholders of record of our common stock and approximately 4,245 beneficial owners.

Stock Performance Graph

The following graph reflects the comparative changes in the value from December 31, 2010 through December 31, 2015, assuming an initial investment of $100 and the reinvestment of dividends, if any, in (1) our common stock, (2) the S&P SmallCap 600 Index, and (3) the Dow Jones U.S. Specialty Chemicals Index. The information under this caption is not deemed to be "soliciting material" or to be "filed" with the SEC or subject to Regulation 14A or 14C under the Securities Exchange Act of 1934 or to the liabilities of Section 18 of the Securities Exchange Act of 1934, and will not be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, except to the extent we specifically incorporate it by reference into such a filing. Historical performance should not be considered indicative of future stockholder returns.

Total Return to Shareholders'
(Includes reinvestment of dividends)

Company Name / Index	Annual Return Percentage, Years Ending 12/31/2011	12/31/2012	12/31/2013	12/31/2014	12/31/2015
Kraton Performance Polymers, Inc.	(34.41)%	18.37 %	(4.08)%	(9.80)%	(20.10)%
S&P SmallCap 600 Index	1.02 %	16.32 %	41.31 %	5.76 %	(1.97)%
Dow Jones U.S. Specialty Chemicals	(2.82)%	32.22 %	22.89 %	8.62 %	(9.79)%

Company Name / Index	Cumulative Value of $100 Investment, through December 31, 2015 Base Period 12/31/10	12/31/2011	12/31/2012	12/31/2013	12/31/2014	12/31/2015
Kraton Performance Polymers, Inc.	$100.00	$65.59	$77.64	$74.47	$67.17	$53.67
S&P SmallCap 600 Index	$100.00	$101.02	$117.51	$166.05	$175.61	$172.15
Dow Jones U.S. Specialty Chemicals	$100.00	$97.18	$128.49	$157.90	$171.51	$154.72

Dividends

We have not previously declared or paid any dividends or distributions on our common stock and have instead deployed earnings to fund the development of our business. Any future determination to pay dividends will be at the discretion of our board of directors and will depend on our financial condition, results of operations, capital expenditure requirements, restrictions contained in current and future financing instruments and other factors that our board of directors deems relevant. Because we are a holding company, our ability to pay dividends depends on our receipt of cash dividends and distributions from our subsidiaries. The terms of the Term Loan Facility, the ABL Facility and the 10.5% Senior Notes restrict our ability and the ability of our subsidiaries to pay dividends, as may the terms of any of our future debt or preferred securities.

Repurchase of Equity Securities

Following is a summary of our repurchases of common stock during the year ended December 31, 2015.

Period	Total Number of Shares Purchased (a)	Average Price Paid Per Share	Total Number of Shares Purchased as Part of a Publicly Announced Program (a)	Maximum Dollar Value (in millions) of Shares that May Yet Be Purchased Under the Program (a)
January 1 - 31, 2015	231,780	$19.60	231,780	$26.8
February 1 - 28, 2015	138,668	$19.56	138,668	$24.1
March 1 - 31, 2015	292,095	$19.19	292,095	$18.5
April 1 - 30, 2015	61,918	$19.92	61,918	$17.3
August 1 - 31, 2015	453,224	$20.59	453,224	$7.9
September 1 - 30, 2015	373,918	$20.98	373,918	$0.0
Total	1,551,603	$20.16	1,551,603	$0.0

No shares were repurchased in the months of May through July or October through December.

(a) On October 27, 2014, our board of directors approved a share repurchase plan which allowed for the repurchase of outstanding shares of our common stock having an aggregate purchase price of up to $50.0 million. From the inception of the program through December 31, 2015, we repurchased a total of 2,549,683 shares of our common stock at an average price of $19.58 per share and a total cost of $50.0 million (including trading commissions). The share repurchase plan was financed with available cash and the program is now complete.

Item 6. Selected Financial Data.

The selected financial data below should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" included under Item 7 of this Form 10-K as well as the consolidated financial statements and the related notes.

	Years ended December 31,				
	2015	2014	2013	2012	2011
	(in thousands, except per share data)				
Consolidated statements of operations data:					
Revenue	$1,034,626	$1,230,433	$1,292,121	$1,423,122	$1,437,479
Cost of goods sold	805,970	993,366	1,066,289	1,191,680	1,121,293
Gross profit	228,656	237,067	225,832	231,442	316,186
Operating expenses:					
Research and development	31,024	31,370	32,014	31,011	27,996
Selling, general and administrative	117,308	104,209	105,558	98,555	101,606
Depreciation and amortization	62,093	66,242	63,182	64,554	62,735
Impairment of long-lived assets	—	4,731	—	5,434	—
Total operating expenses	210,425	206,552	200,754	199,554	192,337
Loss on extinguishment of debt	—	—	—	—	2,985
Earnings of unconsolidated joint venture (1)	406	407	530	530	529
Interest expense, net	24,223	24,594	30,470	29,303	29,884
Income (loss) before income taxes	(5,586)	6,328	(4,862)	3,115	91,509
Income tax expense (benefit)	6,943	5,118	(3,887)	19,306	584
Consolidated net income (loss)	(12,529)	1,210	(975)	(16,191)	90,925
Net loss attributable to noncontrolling interest	(1,994)	(1,209)	(357)	—	—
Net income (loss) attributable to Kraton	$(10,535)	$2,419	$(618)	$(16,191)	$90,925
Earnings (loss) per common share:					
Basic	$(0.34)	$0.07	$(0.02)	$(0.50)	$2.85
Diluted	$(0.34)	$0.07	$(0.02)	$(0.50)	$2.81
Weighted average common shares outstanding:					
Basic	30,574	32,163	32,096	31,939	31,786
Diluted	30,574	32,483	32,096	31,939	32,209

(1) Represents our 50% joint venture interest in Kraton JSR Elastomers K.K., which is accounted for using the equity method of accounting.

	As of December 31,				
	2015	2014	2013	2012	2011
	(in thousands)				
Consolidated balance sheets data:					
Cash and cash equivalents	$70,049	$53,818	$175,872	$223,166	$88,579
Total assets	$1,092,700	$1,076,877	$1,194,797	$1,229,189	$1,153,756
Total debt	$429,197	$351,872	$350,989	$448,017	$392,500

	2015	2014	2013	2012	2011
Other data:					
Ratio of earnings to fixed charges	0.72:1.00	1.11:1.00	0.80:1.00	1.02:1.00	3.54:1.00

Our earnings were insufficient to cover our fixed charges by approximately $9.4 million and $8.7 million for the years ended December 31, 2015 and 2013, respectively.

Adjusted Gross Profit, EBITDA, Adjusted EBITDA, and Adjusted Diluted Earnings Per Share

We consider Adjusted Gross Profit, EBITDA, Adjusted EBITDA and Adjusted Diluted Earnings Per Share to be important supplemental measures of our performance and believe they are frequently used by investors, securities analysts, and other interested parties in the evaluation of our performance and/or that of other companies in our industry, including period-to-period comparisons. In addition, management uses these measures to evaluate operating performance, and our incentive compensation plan bases incentive compensation payments on our Adjusted EBITDA performance, along with other factors. Adjusted Gross Profit, EBITDA, Adjusted EBITDA and Adjusted Diluted Earnings Per Share have limitations as analytical tools and in some cases can vary substantially from other measures of our performance. You should not consider any of them in isolation, or as substitutes for analysis of our results under U.S. generally accepted accounting principles (“GAAP”).

	Years ended December 31,		
	2015	2014	2013
	(in thousands)		
Adjusted Gross Profit (1) (2)	$279,540	$257,936	$260,625
EBITDA (3)	$80,730	$97,164	$88,790
Adjusted EBITDA (1) (4)	$166,817	$147,194	$140,906
Adjusted Diluted Earnings Per Share (1) (2)	$2.02	$1.16	$1.20

(1) Although we report our financial results using the FIFO basis of accounting, as part of our pricing strategy, we measure our business performance using the estimated current replacement cost (“ECRC”) of our inventory and cost of goods sold. We maintain our perpetual inventory in our global enterprise resource planning system, where the carrying value of our inventory is determined using FIFO. At the beginning of each month, we determine the ECRC of our raw materials for that particular month, and using the same perpetual inventory system that we use to manage inventory and therefore costs of goods sold under FIFO, we revalue our ending inventory to reflect the total cost of such inventory as if it was valued using the ECRC. The result of this revaluation from FIFO creates the spread between FIFO and ECRC. With inventory valued under FIFO and ECRC, we then have the ability to report cost of goods sold and therefore Adjusted Gross Profit, Adjusted EBITDA and Adjusted Diluted Earnings Per Share under both our FIFO convention and ECRC.

(2) Adjusted Gross Profit is gross profit net of the impact of the spread between the FIFO basis of accounting and ECRC and net of the impact of items we do not consider indicative of our ongoing operating performance. Similarly, Adjusted Diluted Earnings Per Share is diluted earnings per share net of the impact of the spread between the FIFO basis of accounting and ECRC and net of the impact of items we do not consider indicative of our ongoing operating performance. We explain how each adjustment is derived and why we believe it is helpful and appropriate in the reconciliation below. You are encouraged to evaluate each adjustment and the reasons we consider it appropriate for supplemental analysis. As a measure of our performance, Adjusted Gross Profit and Adjusted Diluted Earnings Per Share are limited because they often vary substantially from gross profit and diluted earnings per share calculated in accordance with US GAAP.

(3) EBITDA represents net income before interest, taxes, depreciation and amortization. Limitations for EBITDA as an analytical tool include the following:

- EBITDA does not reflect the significant interest expense on our debt;
- EBITDA does not reflect the significant depreciation and amortization expense associated with our long-lived assets;
- EBITDA included herein should not be used for purposes of assessing compliance or non-compliance with financial covenants under our debt agreements. The calculation of EBITDA in the debt agreements includes adjustments, such as extraordinary, non-recurring or one-time charges, proforma cost savings, certain non-cash items, turnaround costs, and other items included in the definition of EBITDA in the debt agreements; and
- other companies in our industry may calculate EBITDA differently than we do, limiting its usefulness as a comparative measure.

(4) Adjusted EBITDA is EBITDA net of the impact of the spread between the FIFO basis of accounting and ECRC and net of the impact of items we do not consider indicative of our ongoing operating performance. We explain how each adjustment is derived and why we believe it is helpful and appropriate in the reconciliation below. You are encouraged to evaluate each adjustment and the reasons we consider it appropriate for supplemental analysis. As an analytical tool, Adjusted EBITDA is subject to the limitations applicable to EBITDA described above, as well as the following limitations:

- due to volatility in raw material price, Adjusted EBITDA may, and often does, vary substantially from EBITDA, net income and other performance measures, including net income calculated in accordance with US GAAP; and
- Adjusted EBITDA may, and often will, vary significantly from EBITDA calculations under the terms of our debt agreements and should not be used for assessing compliance or non-compliance with financial covenants under our debt agreements.

Because of these and other limitations, EBITDA and Adjusted EBITDA should not be considered as a measure of discretionary cash available to us to invest in the growth of our business.

Our presentation of non-GAAP financial measures and the adjustments made therein should not be construed as an inference that our future results will be unaffected by unusual or non-recurring items, and in the future we may incur expenses or charges similar to the adjustments made in the presentation of our non-GAAP financial measures.

We compensate for the above limitations by relying primarily on our GAAP results and using Adjusted Gross Profit, EBITDA, Adjusted EBITDA and Adjusted Diluted Earnings Per Share only as supplemental measures. See our financial statements included elsewhere in this Form 10-K.

We reconcile Gross Profit to Adjusted Gross Profit as follows:

	Years ended December 31,		
	2015	2014	2013
	(in thousands)		
Gross profit	$228,656	$237,067	$225,832
Add (deduct):			
Restructuring and other charges (a)	159	651	218
Production downtime (b)	(474)	9,905	3,506
Impairment of spare parts inventory (c)	—	430	—
Non-cash compensation expense (d)	541	628	332
Spread between FIFO and ECRC	50,658	9,255	30,737
Adjusted gross profit	$279,540	$257,936	$260,625

(a) Employee severance costs and other restructuring related charges.

(b) In 2015, the reduction in costs was due to insurance recoveries related to the Belpre production downtime. In 2014, weather-related production downtime at our Belpre, Ohio, facility and an operating disruption from a small fire at our Berre, France, facility. In 2013, production downtime at our Belpre, Ohio facility, in preparation for the installation of natural gas boilers to replace the coal-burning boilers required by the MACT legislation.

(c) Impairment of spare parts inventory associated with the coal-burning boilers which were decommissioned in 2015.

(d) Represents non-cash expense related to equity compensation plans.

We reconcile consolidated net income (loss) to EBITDA, and Adjusted EBITDA as follows:

	Years ended December 31,		
	2015	2014	2013
	(in thousands)		
Net income (loss) attributable to Kraton	$(10,535)	$2,419	$(618)
Net loss attributable to noncontrolling interest	(1,994)	(1,209)	(357)
Consolidated net income (loss)	(12,529)	1,210	(975)
Add (deduct):			
Interest expense, net	24,223	24,594	30,470
Income tax expense (benefit)	6,943	5,118	(3,887)
Depreciation and amortization	62,093	66,242	63,182
EBITDA	80,730	97,164	88,790
Add (deduct):			
Retirement plan charges (a)	792	399	—
Restructuring and other charges (b)	1,729	2,953	815
Transaction and acquisition related costs (c)	20,846	9,585	9,164
Impairment of long-lived assets (d)	—	4,731	—
Impairment of spare parts inventory (e)	—	430	—
Production downtime (f)	(593)	10,291	3,506
KFPC startup costs (g)	3,640	1,911	—
Non-cash compensation expense (h)	9,015	10,475	7,894
Spread between FIFO and ECRC	50,658	9,255	30,737
Adjusted EBITDA	$166,817	$147,194	$140,906

(a) Charges associated with the termination of the defined benefit restoration pension plan, which are primarily recorded in selling, general, and administrative expenses.

(b) Employee severance, professional fees, and other restructuring related charges which are primarily recorded in selling, general, and administrative expenses.

(c) Charges related to the evaluation of acquisition transactions which are recorded in selling, general, and administrative expenses. In 2015, charges are primarily related to the Arizona Chemical Acquisition. In 2014 and 2013, charges are primarily related to the terminated Combination Agreement with LCY.

(d) The charge recognized in 2014 includes $2.4 million related to engineering and design assets for projects we determined were no longer economically viable, $1.4 million related to information technology and office assets associated with restructuring activities, and $0.9 million related to other long-lived assets.

(e) Impairment of spare parts inventory associated with the coal-burning boilers which were decommissioned in 2015 which is recorded in cost of goods sold.

(f) In 2015, the reduction in costs is due to insurance recoveries related to the Belpre production downtime, which are primarily recorded in cost of goods sold. In 2014, weather-related production downtime at our Belpre, Ohio, facility and an operating disruption from a small fire at our Berre, France, facility, of which $9.9 million is recorded in cost of goods sold and $0.4 million is recorded in selling, general, and administrative expenses. In 2013, production downtime at our Belpre, Ohio, facility, in preparation for the installation of natural gas boilers to replace the coal-burning boilers required by the MACT legislation, which is recorded in cost of goods sold.

(g) Startup costs related to the joint venture company, KFPC, which are recorded in selling, general, and administrative expenses.

(h) Represents non-cash expense related to equity compensation plans. We historically recorded these costs in selling, general and administrative expenses; however, beginning in the second quarter of 2013, a portion of these costs were recorded in cost of goods sold and research and development expenses. In 2015, $7.8 million, $0.7 million and $0.5 million, in 2014, $9.0 million, $0.9 million and $0.6 million, and in 2013, $7.1 million, $0.5 million, and $0.3 million were recorded in selling, general, and administrative expenses, research and development expenses, and cost of goods sold, respectively.

We reconcile GAAP Diluted Earnings (Loss) Per Share to Adjusted Diluted Earnings Per Share as follows:

	Years ended December 31,		
	2015	2014	2013
	(in thousands)		
GAAP earnings (loss)	$(0.34)	$0.07	$(0.02)
Retirement plan charges (a)	0.03	0.01	—
Restructuring and other charges (b)	0.05	0.08	0.02
Transaction and acquisition related costs (c)	0.67	0.29	0.28
Impairment of long-lived assets (d)	—	0.14	—
Impairment of spare parts inventory (e)	—	0.01	—
Production downtime (f)	(0.02)	0.31	0.11
KFPC startup costs (g)	0.05	0.02	—
Change in valuation allowance (h)	—	(0.05)	(0.31)
Settlement of interest rate swap (i)	—	—	0.02
Write-off of debt issuance cost (j)	—	—	0.16
Spread between FIFO and ECRC	1.58	0.28	0.94
Adjusted Earnings	$2.02	$1.16	$1.20

(a) Charges associated with the termination of the defined benefit restoration pension plan, which are primarily recorded in selling, general and administrative expenses.

(b) Employee severance, professional fees and other restructuring related charges which are primarily recorded in selling, general and administrative expenses.

(c) Charges related to the evaluation of acquisition transactions which are recorded in selling, general and administrative expenses. In 2015, charges are primarily related to the Arizona Chemical Acquisition. In 2014 and 2013, charges are primarily related to the terminated Combination Agreement with LCY.

(d) The charge recognized in 2014 includes $2.4 million related to engineering and design assets for projects we determined were no longer economically viable, $1.4 million related to information technology and office assets associated with fourth quarter restructuring activities, and $0.9 million related to other long-lived assets.

(e) Impairment of spare parts inventory associated with the coal-burning boilers which were decommissioned in 2015 which is recorded in cost of goods sold.

(f) In 2015, the reduction in costs is due to insurance recoveries related to the Belpre production downtime, which are primarily recorded in cost of goods sold. In 2014, weather-related production downtime at our Belpre, Ohio, facility and an operating disruption from a small fire at our Berre, France, facility, of which $9.9 million is recorded in cost of goods sold and $0.4 million is recorded in selling, general and administrative expenses. In 2013, production downtime at our Belpre, Ohio, facility, in preparation for the installation of natural gas boilers to replace the coal-burning boilers required by the MACT legislation, which is recorded in cost of goods sold.

(g) Startup costs related to the joint venture company, KFPC, which are recorded in selling, general and administrative expenses.

(h) Income tax benefit related to a portion of the change in our valuation allowance for deferred tax assets.

(i) Interest expense related to the termination and settlement of an interest rate swap agreement in connection with the refinancing of our credit facility.

(j) Interest expense related to the write-off of unamortized debt issuance costs in connection with the refinancing of our credit facility.

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

INTRODUCTION

Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with Item 8. Financial Statements and Supplementary Data. This discussion contains forward-looking statements and involves numerous risks and uncertainties, including, but not limited to those described in Item 1A. Risk Factors and below under the caption "Factors Affecting Our Results of Operations." Actual results may differ materially from those contained in any forward-looking statements.

OVERVIEW

We are a leading global specialty chemicals company that manufactures SBCs and other engineered polymers. SBCs are highly-engineered synthetic elastomers, which we invented and commercialized over 50 years ago. We developed the first USBCs in 1964 and the first HSBCs in the late 1960s. Our SBCs enhance the performance of numerous products by imparting greater flexibility, resilience, strength, durability and processability, and are used in a wide range of applications, including adhesives, coatings, consumer and personal care products, sealants, lubricants, medical, packaging, automotive, paving, roofing and footwear products.

The majority of worldwide SBC production is dedicated to USBCs, which are primarily used in paving, roofing, adhesives, sealants, coatings, and footwear applications. HSBC, 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. IR and IRL are non-SBC products which are primarily used in applications such as medical products, personal care, adhesives, tackifiers, paints, and coatings.

Our products are manufactured and our commercial activities are organized in the following product groups based upon polymer chemistry and process technologies:

Product Group Revenue Percentage:	2015		2014		2013	
Performance Products	52.3	%	55.2	%	59.0	%
Specialty Polymers	33.9	%	33.5	%	31.9	%
Cariflex	13.8	%	11.3	%	9.0	%
Other	—	%	—	%	0.1	%

2015 Financial Overview

- Sales volume was 306.5 kilotons in 2015 compared to 305.6 kilotons in 2014.
- Revenue was $1,034.6 million in 2015 compared to $1,230.4 million in 2014.
- Gross profit was $228.7 million in 2015 compared to $237.1 million in 2014. Adjusted gross profit (non-GAAP) was $279.5 million in 2015 compared to $257.9 million in 2014.
- Adjusted EBITDA (non-GAAP) was $166.8 million in 2015 compared to $147.2 million in 2014.
- Net loss attributable to Kraton was $10.5 million or $0.34 per diluted share in 2015 compared to a net income of $2.4 million or $0.07 per diluted share in 2014.
- Adjusted diluted earnings per share (non-GAAP) was $2.02 in 2015 compared to $1.16 in 2014.
- For the year ended December 31, 2015 compared to the year ended December 31, 2014, foreign currency fluctuations had a negative impact on adjusted gross profit and adjusted EBITDA of $16.5 million and $11.0 million, respectively.

See "Part II, Item 6. Selected Financial Data" for reconciliation of adjusted gross profit, EBITDA, adjusted EBITDA and adjusted diluted earnings per share.

RESULTS OF OPERATIONS

Factors Affecting Our Results of Operations

Raw Materials. We use butadiene, styrene, and isoprene as our primary raw materials in manufacturing our products and our results of operations are directly affected by the cost of these raw materials. On a FIFO basis, these monomers together represented approximately $385.2 million, $512.8 million and $609.5 million or 47.8%, 51.6% and 57.2% of our total cost of goods sold for the years ended December 31, 2015, 2014, and 2013, respectively. Since the cost of our three primary raw materials comprise a significant amount of our total cost of goods sold, our selling prices for our products and therefore our total revenue is impacted by movements in our raw material costs, as well as the cost of other inputs.

The cost of these monomers has generally correlated with changes in energy prices and is generally influenced by supply and demand factors and prices for natural and synthetic rubber. In aggregate, average purchase prices for butadiene, isoprene and styrene were lower during 2015 compared to 2014, and lower in 2014 compared to 2013.

We use the FIFO basis of accounting for inventory and cost of goods sold, and therefore gross profit. In periods of raw material price volatility, reported results under FIFO will differ from what the results would have been if cost of goods sold were based on ECRC. Specifically, in periods of rising raw material costs, reported gross profit will be higher under FIFO than under ECRC. Conversely, in periods of declining raw material costs, reported gross profit will be lower under FIFO than under ECRC. In recognition of the fact that the cost of raw materials affects our results of operations and the comparability of our results of operations, we provide the difference, or spread, between FIFO and ECRC. For the years ended December 31, 2015, 2014, and 2013, reported results under FIFO were lower than results would have been on an ECRC basis by $50.7 million, $9.3 million, and $30.7 million, respectively.

International Operations and Currency Fluctuations. We operate a geographically diverse business, serving customers in over 70 countries from five manufacturing facilities on four continents. Our sales and production costs are mainly denominated in U.S. dollars, Euro, Japanese Yen, and Brazilian Real. From time to time, we use hedging strategies to reduce our exposure to currency fluctuations.

We generated our revenue from customers located in the following regions:

Revenue by Geography:	2015		2014		2013	
Americas	38.4	%	38.9	%	39.3	%
Europe, Middle East and Africa	33.1	%	36.4	%	38.7	%
Asia Pacific	28.5	%	24.7	%	22.0	%

Our financial results are subject to gains and losses on currency translations, which occur when the financial statements of foreign operations are translated into U.S. dollars. The financial statements of 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 average exchange rate for each period for revenue, expenses, gains and losses, and cash flows. The effect of translating the balance sheet into U.S. dollars is included as a component of accumulated other comprehensive income (loss). Any appreciation of the functional currencies against the U.S. dollar will increase the U.S. dollar equivalent of amounts of revenue, expenses, gains and losses, cash flows, and any depreciation of the functional currencies will decrease the U.S. dollar amounts reported. Our results of operations are also subject to currency transaction risk. We incur currency transaction risk when we enter into either a purchase or sale transaction using a currency other than the local currency of the transacting entity. The estimated impact from currency fluctuations amounted to a pre-tax loss of $9.8 million, a pre-tax income of $0.4 million and a pre-tax loss of $4.8 million for the years ended December 31, 2015, 2014, and 2013, respectively. The primary driver for the pre-tax loss in 2015 and the pre-tax income in 2014 was the change in foreign currency exchange rates between the Euro and U.S. dollar. The primary driver for our pre-tax loss in 2013 was the change in foreign currency exchange rates between the Japanese Yen and U.S. dollar.

Seasonality. Seasonal changes and weather conditions typically affect our Performance Products sales into paving and roofing applications, which generally results in higher sales volumes in the second and third quarters of the calendar year compared to the first and fourth quarters of the calendar year. Our other markets tend to show relatively little seasonality.

Year Ended December 31, 2015 Compared to Year Ended December 31, 2014

Revenue

Revenue was $1,034.6 million for the year ended December 31, 2015 compared to $1,230.4 million for the year ended December 31, 2014, a decrease of $195.8 million or 15.9%. The negative effect of currency movements accounted for $89.1 million of the decline. The remaining decline was due to lower average selling prices amounting to $112.2 million primarily driven by lower average raw material costs, partially offset by $5.5 million due to higher sales volumes. Sales volumes were 306.5 kilotons for the year ended December 31, 2015 compared to 305.6 kilotons for the year ended December 31, 2014.

With respect to revenue for each of our product groups:

- Cariflex™ revenue was $142.9 million for the year ended December 31, 2015 compared to $138.6 million for the year ended December 31, 2014, an increase of $4.3 million or 3.1%. Cariflex sales volumes increased 10.2% compared to the year ended December 31, 2014, driven primarily by higher sales into surgical glove applications. Higher sales volume, amounting to $14.5 million, was partially offset by a $7.7 million negative effect from currency fluctuations and $2.5 million associated with lower selling prices primarily resulting from lower raw material costs.
- Specialty Polymers revenue was $350.7 million for the year ended December 31, 2015 compared to $412.4 million for the year ended December 31, 2014, a decline of $61.7 million, or 15.0%. The negative effect of currency fluctuations accounted for $19.6 million of the decline. The remaining decline reflects a $27.4 million impact from lower average selling prices primarily related to lower raw material costs and $14.8 million due to a 3.4% decline in sales volumes. The decline in sales volume was largely due to lower sales into lubricant additive applications associated with inventory reduction measures by a significant customer, and, to a lesser extent, lower sales into personal care applications. Partially offsetting these declines were higher sales into medical, cable gel and consumer applications.
- Performance Products revenue was $540.6 million for the year ended December 31, 2015 compared to $678.9 million for the year ended December 31, 2014, a decline of $138.3 million, or 20.4%. The decline includes a $61.8 million negative effect of currency fluctuations. The remaining decline was due to lower average selling prices primarily resulting from lower raw material costs. Sales volume increased modestly, despite the previously disclosed seven kilotons of lost production at our Wesseling and Berre facilities in the second quarter 2015. The increase in sales volume was driven by higher sales into North American paving applications and personal care applications, largely offset by lower sales into adhesives and roofing applications.

Cost of Goods Sold

Cost of goods sold was $806.0 million for the year ended December 31, 2015, a decline of $187.4 million, or 18.9%, compared to $993.4 million for the year ended December 31, 2014. The decline was due to lower raw material costs of $96.0 million, changes in foreign currency exchange rates of $74.0 million, and $12.4 million from the implementation of our previously announced cost reduction initiatives. In addition, cost of goods sold in 2014 included $10.4 million of costs associated with production downtime at two of our facilities. These decreases were partially offset by $5.4 million of higher other manufacturing costs.

Gross Profit

Gross profit was $228.7 million for the year ended December 31, 2015 compared to $237.1 million for the year ended December 31, 2014. Gross profit as a percentage of revenue was 22.1% and 19.3% for the years ended December 31, 2015 and 2014, respectively.

Operating Expenses

Research and development expenses were $31.0 million for the year ended December 31, 2015 compared to $31.4 million for the year ended December 31, 2014. The $0.4 million decrease includes $2.8 million of savings from the implementation of our previously announced cost reduction initiatives, largely offset by higher variable employee compensation and other operating costs.

Selling, general and administrative expenses were $117.3 million for the year ended December 31, 2015 compared to $104.2 million for the year ended December 31, 2014, an increase of $13.1 million, or 12.6%. This increase was primarily due to an $11.3 million increase in transaction and acquisition related costs, a $7.2 million increase in employee related expenses, primarily variable compensation expense, and a $2.3 million increase in other professional fees. These increases were partially offset by a $3.9 million positive effect from currency fluctuations and a $4.1

million reduction from the implementation of our previously announced cost reduction initiatives.
Depreciation and amortization was $62.1 million for the year ended December 31, 2015 compared to $66.2 million for the year ended December 31, 2014, a decrease of $4.1 million, of which $2.6 million was due to changes in foreign currency.

The $4.7 million impairment of long-lived assets in 2014 included $2.4 million related to engineering and design assets for projects we determined were no longer economically viable, $1.4 million related to information technology and office assets arising from restructuring activities, and $0.9 million related to other long-lived assets. We did not incur any impairment charges for the year ended December 31, 2015.

Interest expense, net

Interest expense, net was $24.2 million for the year ended December 31, 2015 compared to $24.6 million for the year ended December 31, 2014, a decrease of $0.4 million or 1.5%.

Income tax expense (benefit)

Income tax expense was $6.9 million and $5.1 million for the years ended December 31, 2015 and 2014, respectively. Our effective tax rate was 124.3% and 80.9% for the years ended December 31, 2015 and 2014, respectively. Our effective tax rates differed from the U.S. corporate statutory tax rate of 35.0%, primarily due to the mix of pre-tax income or loss earned in foreign jurisdictions and losses generated in the U.S. tax jurisdiction for which a full valuation allowance has been provided, as well as uncertain tax positions. See Note 11 Income Taxes, for further information.

We record a valuation allowance when it is more likely than not that some portion, or all, of the deferred tax assets will not be realized. As of December 31, 2015 and December 31, 2014, a valuation allowance of $100.1 million and $90.4 million, respectively, has been provided for net operating loss carryforwards and other deferred tax assets. We increased our valuation allowance by $9.7 million in 2015, which includes $13.9 million related to current period net operating losses in the U.S. jurisdiction, partially offset by a $2.7 million decrease related to the tax effect of unrealized pension gains, and a $1.5 million decrease related to changes in other comprehensive income (loss). We increased our valuation allowance by $0.4 million in 2014, which includes a $9.8 million increase related to changes in other comprehensive income (loss), partially offset by a $7.6 million decrease related to current year operating income and a $1.8 million decrease related to the assessment of our ability to utilize net operating loss carryforwards in future periods. We consider the reversal of deferred tax liabilities within the net operating loss carryforward period, projected future taxable income and tax planning strategies in making this assessment. Excluding the change in our valuation allowance, our effective tax rates would have been a 75.4% benefit and a 229.0% expense for the years ended December 31, 2015 and 2014, respectively. As of December 31, 2015, $87.9 million of the $100.1 million valuation allowance is associated with net deferred tax assets in the U.S. jurisdiction.

Following the Arizona Chemical Acquisition, we project that we will have sufficient combined pre-tax earnings in the U.S. to fully utilize net operating loss carryforwards within a reasonable projection period. Under ASC 805-740-30-3, the release of an acquirer's existing valuation allowance resulting from an acquisition is recognized as an adjustment to the financial statements as of the acquisition date. As a result, we expect to release the valuation allowance related to the U.S. net deferred tax assets in 2016.

Net income (loss) attributable to Kraton

Net loss attributable to Kraton was $10.5 million, or $0.34 per diluted share, for the year ended December 31, 2015, a decrease of $13.0 million, compared to net income of $2.4 million, or $0.07 per diluted share, for the year ended December 31, 2014. Adjusted diluted earnings per share (non-GAAP) was $2.02 in 2015 compared to $1.16 in 2014. See Item 6. Selected Financial Data for a reconciliation of GAAP diluted earnings (loss) per share to adjusted diluted earnings per share.

Year Ended December 31, 2014 Compared to Year Ended December 31, 2013

Revenue

Revenue was $1,230.4 million for the year ended December 31, 2014 compared to $1,292.1 million for the year ended December 31, 2013, a decline of $61.7 million or 4.8% (a decline of $50.3 million or 3.9% excluding an $11.4 million negative effect from currency fluctuations) with $51.3 million of the decline attributable to lower average selling prices associated with lower average raw material costs. Sales volumes declined 7.9 kilotons or 2.5% from 313.5 kilotons for the year ended December 31, 2013 to 305.6 kilotons for the year ended December 31, 2014. The decrease in total sales volume did not have a material impact on the period-over-period change in revenue, as the revenue impact from lower sales volume in our Performance Products business was more than offset by the revenue contribution from increased sales volume in the higher revenue per ton Cariflex™ and Specialty Polymers businesses.

With respect to revenue for each of our product groups:

- Cariflex™ revenue was $138.6 million for the year ended December 31, 2014 compared to $116.0 million for the year ended December 31, 2013. The $22.6 million or 19.5% revenue increase (an increase of $25.4 million or 21.9% excluding a $2.8 million negative effect from currency fluctuations) was due to a 24.1% increase in sales volumes led by sales into surgical glove applications, and to a lesser extent, increased sales into condom and medical stopper markets. The revenue contribution from higher sales volume was partially offset by lower average selling prices due to lower isoprene costs.

- Specialty Polymers revenue was $412.4 million for the year ended December 31, 2014 compared to $412.0 million for the year ended December 31, 2013. The $0.4 million or 0.1% revenue increase (an increase of $1.5 million or 0.4% excluding a $1.1 million negative effect from currency fluctuations) was due to a 4.6% increase in sales volume, which was offset by lower average selling prices reflective of lower raw material costs. The increase in sales volume was primarily due to growth in lubricant additives, cable gels, and polymer modification applications partially offset by lower volume into personal care applications.
- Performance Products revenue was $678.9 million for the year ended December 31, 2014 compared to $762.9 million for the year ended December 31, 2013. The $84.0 million or 11.0% revenue decline (a decline of $76.5 million or 10.0% excluding a $7.5 million negative effect from currency fluctuations) was due to a 6.2% reduction in sales volumes and, to a lesser extent, lower average selling prices driven by lower butadiene and isoprene costs. The decline in sales volume was primarily due to lower paving and roofing volumes in Europe, lower paving volumes in Asia Pacific and lower volumes into packaging & industrial adhesives applications.

Cost of Goods Sold

Cost of goods sold was $993.4 million for the year ended December 31, 2014 compared to $1,066.3 million for the year ended December 31, 2013. The $72.9 million or 6.8% decrease was primarily driven by a $66.0 million reduction in raw material costs (including a period over period benefit of $21.5 million due to the spread between FIFO and ECRC), an $18.6 million decrease from lower sales volumes, and an $11.1 million decrease due to foreign currency fluctuations. Partially offsetting these decreases were $9.9 million of costs associated with the weather-related production downtime at our Belpre, Ohio, facility and an operating disruption from a small fire at our Berre, France, facility in the first quarter of 2014 and increases in other variable and manufacturing costs.

Gross Profit

Gross profit was $237.1 million for the year ended December 31, 2014 compared to $225.8 million for the year ended December 31, 2013. Gross profit as a percentage of revenue was 19.3% and 17.5% for the years ended December 31, 2014 and 2013, respectively.

Operating Expenses

Research and development expenses were $31.4 million for the year ended December 31, 2014 compared to $32.0 million for the year ended December 31, 2013, a decrease of $0.6 million or 2.0% primarily due to lower professional fees and maintenance costs partially offset by higher employee related costs. Research and development expenses were 2.5% of revenue for both of the years ended December 31, 2014 and 2013.

Selling, general and administrative expenses were $104.2 million for the year ended December 31, 2014 compared to $105.6 million for the year ended December 31, 2013, a decrease of $1.3 million or 1.3%. The decrease was primarily due to a $1.3 million decrease in employee related costs, a $1.0 million decrease in professional fees and a $0.8 million decrease in information technology costs. These decreases were partially offset by a $1.7 million increase in restructuring related costs and a $0.4 million increase in transaction and acquisition related costs. Selling, general and administrative expenses were 8.5% and 8.2% of revenue for the years ended December 31, 2014 and 2013, respectively.

Depreciation and amortization was $66.2 million for the year ended December 31, 2014 compared to $63.2 million for the year ended December 31, 2013, an increase of $3.1 million or 4.8%, largely due to capital expenditures.

We incurred impairments of long-lived assets of $4.7 million for the year ended December 31, 2014 related to engineering and design, information technology, and other long-lived assets. We did not incur any impairment charges for the year ended December 31, 2013.

Interest expense, net

Interest expense, net was $24.6 million for the year ended December 31, 2014 compared to $30.5 million for the year ended December 31, 2013, a decrease of $5.9 million or 19.3%. The decrease was primarily due to charges aggregating $5.8 million incurred in connection with our March 2013 refinancing and to lower outstanding indebtedness in 2014.

Income tax expense (benefit)

Our income tax provision was a $5.1 million expense and a $3.9 million benefit for the years ended December 31, 2014 and 2013, respectively. Our effective tax rate was 80.9% and 79.9% for the years ended December 31, 2014 and 2013, respectively. Our effective tax rates differed from the U.S. corporate statutory tax rate of 35.0%, primarily due to the mix of pre-tax income or loss earned in certain jurisdictions and the change in our valuation allowance.

We record a valuation allowance when it is more likely than not that some portion or all of the deferred tax assets will not be realized. As of December 31, 2014 and December 31, 2013, a valuation allowance of $90.4 million and $90.0 million, respectively, has been provided for net operating loss carryforwards and other deferred tax assets. We increased our valuation allowance by $0.4 million in 2014, which includes a $9.8 million increase related to changes in other comprehensive income (loss), partially offset by a $9.4 million decrease to the income tax provision. The $9.4 million is comprised of $7.6 million related to current year operating income and $1.8 million related to the assessment of our ability to utilize net operating loss carryforwards in future periods. We decreased our valuation allowance by $0.4 million in 2013, which includes a $0.5 million decrease due to changes in other comprehensive income (loss), partially offset by a $0.1 million increase to the income tax provision. The $0.1 million is comprised of $10.2 million related to current year operating losses, offset by a $10.1 million benefit related to the tax effect of unrealized pension gains. We consider the reversal of deferred tax liabilities within the net operating loss carryforward period, projected future taxable income and tax planning strategies in making this assessment. Excluding the change in our valuation allowance, our effective tax rates would have been a 229.0% expense and an 81.4% benefit for the years ended December 31, 2014 and 2013, respectively.

Net income (loss) attributable to Kraton

Net income attributable to Kraton was $2.4 million, or $0.07 per diluted share, for the year ended December 31, 2014, an increase in net income of $3.0 million, compared to a net loss of $0.6 million, or $0.02 per diluted share, for the year ended December 31, 2013. Adjusted diluted earnings per share (non-GAAP) was $1.16 in 2014 compared to $1.20 in 2013. See Item 6. Selected Financial Data for a reconciliation of GAAP diluted earnings (loss) per share to adjusted diluted earnings per share.

Critical Accounting Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make assumptions and estimates that directly affect the amounts reported in the consolidated financial statements. Certain critical accounting policies requiring significant judgments, estimates, and assumptions are described in this section. We consider an accounting estimate to be critical if (1) it requires assumptions to be made that are uncertain at the time the estimate is made and (2) changes to the estimate or different estimates that could have reasonably been used would have materially changed our consolidated financial statements. We believe the current assumptions and other considerations used to estimate amounts reflected in our consolidated financial statements are appropriate. However, should our actual experience differ from these assumptions and other considerations used in estimating these amounts, the impact of these differences could have a material impact on our consolidated financial statements.

Allowance for Doubtful Accounts. The allowance for doubtful accounts is our best estimate of the amount of probable credit losses in our existing receivables and is determined based on our assessment of the credit worthiness of individual customers, historical write-off experience, and global economic data. We review the allowance for doubtful accounts quarterly. 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. Inventory values include all costs directly associated with manufacturing products and are stated at the lower of cost or market, primarily determined on a first-in, first-out basis. We evaluate the carrying cost of our inventory on a quarterly basis for this purpose. If the cost of the inventories exceeds their market value, provisions are made for the difference between the cost and the market value.

Property, Plant, and Equipment. Property, plant, and equipment are recorded at cost, net of accumulated depreciation. Major renewals and improvements that extend the useful lives of equipment are capitalized. Repair and maintenance costs are expensed as incurred. Disposals are removed at carrying cost less accumulated depreciation with any resulting gain or loss reflected in earnings. We capitalize interest costs which are incurred as part of the cost of constructing major facilities and equipment. Depreciation is recognized using the straight-line method over the following estimated useful lives:

Machinery and equipment	20 years
Building and land improvements	20 years

Manufacturing control equipment	10 years
Office equipment	5 years
Research equipment and facilities	5 years
Vehicles	5 years
Computer hardware and information systems	3 years

Impairment of Long-Lived Assets. In accordance with the Impairment or Disposal of Long-Lived Assets Subsections of FASB ASC Subtopic 360-10, Property, Plant, and Equipment—Overall, 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, impairment is recognized to the 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.
Asset Retirement Obligations ("ARO"). Our ARO consists of estimated costs of dismantlement, removal, site reclamation, and similar activities associated with our facilities. We recognize the fair value of a liability for an ARO in the period in which we have an existing legal obligation associated with the retirement of our facilities and the obligation can reasonably be estimated. The associated asset retirement cost is capitalized as part of the carrying cost of the asset. The recognition of an ARO requires that we make numerous estimates, assumptions, and judgments regarding such factors as the existence of a legal obligation for an ARO; estimated probabilities, amounts and timing of settlements; the credit-adjusted risk-free rate to be used; discount rate; and inflation rates. In periods subsequent to initial measurement of the ARO, we recognize changes in the liability resulting from the accretion of the liability to its non-discounted amount and revisions to either the timing or the amount of the original estimate of undiscounted cash flows. Revisions also result in increases or decreases in the carrying cost of these assets. Increases in the ARO liability due to accretion is charged to depreciation and amortization expense. The related capitalized cost, including revisions thereto, is charged to depreciation and amortization expense. See Note 12 Commitments and Contingencies (subsection (c)) to the consolidated financial statements.
Contingencies. We are routinely involved in litigation, claims, and disputes incidental to our business. Professional judgment is required to classify the likelihood of these contingencies occurring. A contingency is categorized as probable, reasonably possible, or remote. A contingency is classified as probable if the future event or events are likely to occur. For the probable contingencies, a loss is accrued and disclosed as of the date of the financial statements if it is both probable that an asset has been impaired or a liability has been incurred at the date of the financial statements and the amount of loss can be reasonably estimated. A reasonably possible contingency occurs if the chance of the future event or events happening is more than remote but less than likely (reasonably possible but not probable). We disclose the loss contingencies in the footnotes to the financial statements but do not recognize any liability. A remote contingency is one where the chance of the future event or events occurring is slight. We neither accrue for nor disclose the liability in the notes to the financial statements.
Share-Based Compensation. Share-based compensation cost is measured at the grant date based on the fair value of the award. We recognize these costs using the straight-line method over the requisite service period. The Kraton Performance Polymers, Inc. 2009 Equity Incentive Plan (the "Equity Plan") allows for the grant to key employees, independent contractors, and eligible non-employee directors of incentive stock options, non-qualified stock options (which together with the incentive stock options, are referred to herein as ("Options")), stock appreciation rights, restricted stock awards, and restricted stock units, in addition to other equity or equity-based awards (including performance-based awards) as our board determines from time to time. We estimate the fair value of stock options using the Black-Scholes valuation model. Since our equity interests were privately held prior to our initial public offering we have limited publicly traded stock history, and as a result our estimated volatility is based on a combination of our historical volatility and similar companies' stock that are publicly traded. Until such time that we have enough publicly traded stock history to estimate volatility based solely on our stock, we expect to estimate volatility of options granted based on a combination of our historical volatility and similar companies' stock that are publicly traded. The expected term of options represents the period of time that options granted are expected to be outstanding. For all periods presented, we used the simplified method to calculate the expected term of options. 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. For all periods presented, the dividend yield is assumed to be zero based on historical and expected dividend activity. Forfeitures are based substantially on the history of cancellations of similar awards granted in prior years. See Note 4 Share-Based Compensation to the consolidated financial statements.

Income Taxes. We conduct operations in separate legal entities in different jurisdictions. As a result, income tax amounts are reflected in our consolidated financial statements for each of those jurisdictions.

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 and tax basis of the assets and liabilities as well as the ultimate realization of any deferred tax asset resulting from such differences. 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 determining whether a valuation allowance is required, the company evaluates primarily (a) the impact of cumulative losses in past years and (b) current and/or recent losses. A recent trend in earnings despite cumulative losses is a prerequisite to considering not recording a valuation allowance.

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.

Benefit Plan Valuations. We sponsor a noncontributory defined benefit pension plan (“Pension Plan”) and an additional post-retirement benefit plan (“Retiree Medical Plan”). We annually evaluate significant assumptions related to the benefits and obligations of these plans. Our estimation of the projected benefit obligations and related benefit expense requires that certain assumptions be made regarding such variables as expected return on plan assets, discount rates, rates of future compensation increases, estimated future employee turnover rates and retirement dates, distribution election rates, mortality rates, retiree utilization rates for health care services, and health care cost trend rates. The determination of the appropriate assumptions requires considerable judgment concerning future events and has a significant impact on the amount of the obligations and expense recorded. We rely in part on actuarial studies when determining the appropriateness of certain of the assumptions used in determining the benefit obligations and the annual expenses for these plans.

The discount rates are determined annually and are based on rates of return of high-quality long-term fixed income securities currently available with maturities consistent with the projected benefit payout period. The expected long-term rate of return on assets is derived from a review of anticipated future long-term performance of individual asset classes and consideration of an appropriate asset allocation strategy, given the anticipated requirements of the Pension Plan, to determine the average rate of earnings expected on the funds invested to provide for the pension plan benefits. We also consider recent fund performance and historical returns in establishing the expected rate of return. Movements in the capital markets impact the market value of the investment assets used to fund our Pension Plan. Future changes in plan asset returns, assumed discount rates, and various other factors related to our pension and post-retirement plans will impact future pension expenses and liabilities.

The estimated effect of alternate assumptions on the 2016 estimated annual expense for the Pension Plan and Retiree Medical Plan were performed at varying discount rates, expected return on assets, expected salary increase, and, in the case of our Retiree Medical Plan, health care cost increases.

The measurement date of the Pension Plan’s assets and obligations was December 31, 2015. We applied a 4.55% discount rate, assumed an 8.5% long term expected rate of return on plan assets and assumed an expected salary rate increase of 3.0%. The percentage of equity securities in our Pension Plan as of December 31, 2015 was approximately 57.1%, down from approximately 61.7% as of December 31, 2014, and the percentage of debt securities as of December 31, 2015 was approximately 33.5%, up from approximately 28.8% as of December 31, 2014. The plan’s strategic target asset allocation as of December 31, 2015 was 50% equity, 30% debt and 20% other, with the “other” component consisting of a global market fund and a real estate fund, among others. We have assumed that the funds in the “other” category together would behave similarly to debt and therefore included the 20% “other” as bonds in our assessment.

We estimated a range of returns on the plan assets using a historical stochastic simulation model that determines the compound average annual return (assuming these asset classes—stocks, bonds and cash) over a 20-year historical period (the approximate duration of our liabilities under the Pension Plan). The distribution of results from these simulations is then used to determine a median expected asset return.

Based on the plan’s current target asset allocation, the median estimate for future asset returns (before non-investment expenses) was 9.0%. The asset return assumption set for determining the 2015 FASB ASC 715 expense was 8.5%, after non-investment expenses paid by the Trust. For the past three years, non-investment related expenses have averaged 0.5%. Therefore, the 8.5% return after non-investment expenses assumption is equivalent to a gross assumption of 9.0% (8.5% + 0.5%). A 9.0% rate (before non-investment expenses) falls within an acceptable range of simulated asset returns, between the 40th and 60th percentile.

For the Pension Plan, a 100 basis point decrease in the assumed discount rate would result in a corresponding increase of $2.8 million in our estimated Pension Plan expense for 2016. A 100 basis point decrease from 8.5% in the rate of return on plan assets would result in a corresponding increase of $1.0 million and a 100 basis point increase in the expected salary rate would result in a corresponding increase of $1.1 million in expenses for 2016, in each case holding all other assumptions and factors constant.

For the Retiree Medical Plan, a 100 basis point decrease in the assumed discount rate would result in a corresponding increase of $0.4 million in our estimated expense and a 100 basis point increase in the assumed health care trend rate would result in a corresponding increase of $0.1 million in our estimated expense for 2016, in each case holding all other assumptions and factors constant. For additional information about our benefit plans, See Note 13 Employee Benefits to the consolidated financial statements.
Revenue Recognition. Sales are recognized in accordance with the provisions of ASC 605, Revenue Recognition—Overall, when the revenue is realized or realizable, and has been earned. Revenue for product sales is recognized when risk and title to the product transfer to the customer. Our products are generally sold 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. Our standard terms of delivery are included in our contracts of sale, order confirmation documents, and invoices. Shipping and other transportation costs charged to customers are recorded in both revenue and cost of goods sold. 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 ratably, as a reduction of revenue.

LIQUIDITY AND CAPITAL RESOURCES
On January 6, 2016, we completed our acquisition of Arizona Chemical, a leading global producer of specialty chemicals and other products primarily derived from pine wood pulping co-products. We acquired Arizona Chemical for a cash purchase price of $1.37 billion, which is subject to adjustment for cash, indebtedness, working capital and other items. On January 6, 2016, the $1.37 billion cash purchase price, the cash tender offer and redemption of all outstanding 6.75% Senior Notes, and the related acquisition and financing expenses for the Arizona Chemical Acquisition were funded through the following transactions:
- A $1,350.0 million senior secured term loan facility,
- A private offering of $440.0 million in aggregate principal amount of 10.5% senior notes, and
- An amended and restated $250.0 million asset-based revolving credit facility, $37.1 million of which was drawn on the closing date.

Our previously outstanding indebtedness under the 6.75% Senior Notes and the previous Senior Secured Credit Facilities were satisfied and canceled on January 6, 2016. As such, the following discussion focuses on the capital structure subsequent to the January 6, 2016 close of the above financing arrangements in conjunction with the Arizona Chemical Acquisition. For a description of our indebtedness outstanding at December 31, 2015, see Note 7 Long-Term Debt which is incorporated herein by reference.
In total, we incurred approximately $19.0 million of costs related to the close of the Arizona Chemical Acquisition, of which $18.5 million were recorded in selling, general and administrative expenses in the year ended December 31, 2015. Furthermore, we incurred approximately $59.0 million of debt financing costs associated with Arizona Chemical Acquisition, of which $8.8 million were capitalized in debt issuance costs in the December 31, 2015 consolidated balance sheet. In the first quarter of 2016, we also expect to recognize $9.1 million of cost for the early redemption premium on the 6.75% Senior Notes.
Description of the Senior Secured Term Loan Facility
In January 2016, Kraton Polymers LLC entered into a senior secured term loan facility in an aggregate principal amount equal to $1,350.0 million that matures on January 6, 2022 (the “Term Loan Facility”). Subject to compliance with certain covenants and other conditions, we have the option to borrow up to $350.0 million of incremental term loans plus an additional amount subject to a senior secured net leverage ratio.
The Term Loan Facility was issued at a price of 97.000%. Borrowings under the Term Loan Facility bear interest at a rate per annum equal to an applicable margin, plus, at our option, either (a) an adjusted LIBOR rate (subject to a 1.0% floor) determined by reference to the costs of funds for U.S. dollar deposits for the interest period relevant to such borrowing adjusted for statutory reserve requirements or (b) an alternate base rate (subject to a 2.0% floor) determined by reference to the highest of (1) the prime rate of Credit Suisse AG, (2) the federal funds effective rate plus 0.5% and (3) the one month adjusted LIBOR rate plus 1.0% per annum. In addition, we are required to pay customary agency fees. As of the date of this filing, the effective rate on the Term Loan Facility was 6.0% comprised of the 1.0% LIBOR floor plus a 5.0% applicable margin.

We are required to make scheduled quarterly payments on our term facility of 2.5% of the original principal amount per year through the end of the last quarter of 2016 and 5.0% thereafter, with the balance expected to be due and payable in full on January 6, 2022. Voluntary prepayments on the Term Loan Facility may be made without premium or penalty other than customary “breakage” costs with respect to LIBOR loans and other than a 1.0% premium in connection with certain repricing transactions consummated within a certain period of time after the closing of the Term Loan Facility. In the event we have consolidated excess cash flow for any fiscal year, we are required to prepay an amount of borrowings under the Term Loan Facility equal to at least 50% of such cash flow by the 90th day after the end of the fiscal year. The prepayment percentage is reduced to 25% if our senior secured net leverage ratio is under 2.5:1.0 or 0% if our senior secured net leverage ratio is below 2.0:1.0.

The Term Loan Facility is a senior secured obligation that is guaranteed by Kraton Performance Polymers, Inc. and each of our wholly-owned domestic subsidiaries. The Term Loan Facility contains a number of customary affirmative and negative covenants. These covenants include a senior secured net leverage ratio which shall not exceed, as of the last day of any fiscal quarter, 4.00:1.00 through March 31, 2017, which will decrease to 3.75:1.00 through March 31, 2018, 3.50:1.00 through March 31, 2019, and 3.25:1.00 thereafter. As of the date of this filing, we were in compliance with the covenants under the Term Loan Facility.

Description of the 10.5% Senior Notes due 2023

Kraton Polymers LLC and its wholly-owned financing subsidiary Kraton Polymers Capital Corporation issued $440.0 million aggregate principal amount of 10.5% senior notes that mature on April 15, 2023 (the “10.5% Senior Notes”). The 10.5% Senior Notes were issued at a price of 96.225% on January 6, 2016. The 10.5% Senior Notes are general unsecured, senior obligations and are unconditionally guaranteed on a senior unsecured basis by each of Kraton Performance Polymers, Inc. and each of our wholly-owned domestic subsidiaries. We pay interest on the notes at 10.5% per annum, semi-annually in arrears on April 15 and October 15 of each year, with the first interest payment due on October 15, 2016. Prior to October 15, 2018, we may redeem up to 40.0% of the aggregate principal amount of the notes with the net proceeds of certain equity offerings at a redemption price equal to 110.500% of the principal amount of the 10.5% Senior Notes plus accrued and unpaid interest, if any, to the date of redemption. After October 15, 2018, 2019, 2020, and 20121 and thereafter, we may redeem all or a part of the senior notes for 107.875%, 105.250%, 102.625%, and 100.000% of the principal amount, respectively.

Description of the ABL Facility

In January 2016, we entered into an amended and restated asset-based revolving credit facility which provides financing of up to $250.0 million (the “ABL Facility”). The ABL Facility is primarily secured by receivables and inventory, and borrowing availability under the facility is subject to borrowing base limitations based on the level of receivables and inventory available for security. Revolver commitments under the ABL facility consist of U.S. and Dutch revolving credit facility commitments, and the terms of the facility require the U.S. revolver commitment comprises at least 60.0% of the commitments under the facility.

The ABL Facility provides that we have the right at any time to request up to $100.0 million of additional commitments under this facility, provided that we satisfy additional conditions described in the credit agreement and provided further that the U.S. revolver commitment comprises at least 60.0% of the commitments after giving effect to such increase. We cannot guarantee that all of the lending counterparties contractually committed to fund a revolving credit draw request will actually fund future requests, although we currently believe that each of the counterparties would meet their funding requirements. The ABL Facility terminates on January 6, 2021; however, we may, from time to time, request that the lenders extend the maturity of their commitments; provided that at no time shall there be more than four different maturity dates under the ABL Facility.

Borrowings under the ABL Facility bear interest at a rate per annum equal to the applicable margin plus (1) a base rate determined by reference to the prime rate of Bank of America, N.A. in the jurisdiction where the currency is being funded or (2) LIBOR for loans that bear interest based on LIBOR. The initial applicable margin for borrowings under our ABL Facility is 0.5% with respect to U.S. base rate borrowings and 1.5% with respect to LIBOR or borrowings made on a European base rate. The applicable margin ranges from 0.5% to 1.0% with respect to U.S. base rate borrowings and 1.5% to 2.0% for LIBOR or borrowings made on a European base rate per annum based on the average excess availability for the prior fiscal quarter. In addition to paying interest on outstanding principal amounts under the ABL Facility, we are required to pay a commitment fee in respect of the unutilized commitments at an annual rate of 0.375%.

The ABL Facility contains a financial covenant requiring us to maintain a minimum fixed charge coverage ratio of 1.0 to 1.0 if availability under the facility is below a specified amount. Our failure to comply with this financial maintenance covenant would give rise to a default under the ABL Facility. If factors arise that negatively impact our profitability, we may not be able to satisfy this covenant. In addition, the ABL Facility contains customary events of default, including, without limitation, a failure to make payments under the facility, cross-default with respect to other indebtedness and cross-judgment default, certain bankruptcy events and certain change of control events. If we are unable to satisfy the covenants or other provisions of the ABL Facility at any future time, we would need to seek an amendment or waiver of such covenants or other provisions. The respective lenders under the ABL Facility may elect not to consent to any amendment or waiver requests that we may make in the future, and, if they do consent, they may do so on terms that are not favorable to us. In the event that we are unable to obtain any such waiver or amendment and we are not able to refinance or repay our ABL Facility, our inability to meet the covenants or other provisions of the ABL Facility would constitute an event of default, which would permit the bank lenders to accelerate the ABL Facility. Such acceleration may in turn constitute an event of default under our Term Loan Facility, 10.5% Senior Notes or other indebtedness. As of the date of this filing, we were in compliance with the covenants under the ABL Facility.

Description of the KFPC Loan Agreement

On July 17, 2014, KFPC executed a syndicated loan agreement (the "KFPC Loan Agreement") in the amount of 5.5 billion New Taiwanese Dollars ("NTD"), or $167.5 million (converted at the December 31, 2015 exchange rate), to provide additional funding to construct the HSBC facility in Taiwan and to provide funding for working capital requirements and/or general corporate purposes.

The KFPC Loan Agreement is comprised of a NTD 4.29 billion Tranche A, or $130.6 million (converted at the December 31, 2015 exchange rate), to fund KFPC’s capital expenditures, and a NTD 1.21 billion Tranche B, or $36.9 million (converted at the December 31, 2015 exchange rate), to fund working capital requirements and/or general corporate purposes. As of December 31, 2015, NTD 2.53 billion, or $76.9 million (converted at the December 31, 2015 exchange rate) was drawn and outstanding on the KFPC Loan Agreement. The facility period of the KFPC Loan Agreement is five years from January 17, 2015 (the first drawdown date). KFPC may continue to draw on the loan agreement for the first 28 months following the first drawdown date. Subject to certain conditions, KFPC can request a two-year extension of the term of the KFPC Loan Agreement.

The total outstanding principal amount is payable in six semi-annual installments with the first payment due on July 17, 2017 and each subsequent payment due every six months thereafter. The first five installments shall be in an amount equal to 10% of the outstanding principal amount and the final installment shall be in an amount equal to the remaining 50% of the outstanding principal amount. In the event the extension period is granted, the final 50% of the outstanding principal amount shall be repaid in five equal semi-annual installments with the first installment due on the original final maturity date.

The KFPC Loan Agreement is subject to a variable interest rate composed of a fixed 0.8% margin plus the three-month or six-month fixing rate of the Taipei Interbank Offered Rate (depending on the interest period selected by KFPC in the drawdown request or the interest period notice), subject to a floor of 1.7%. Interest is payable on a monthly basis.

The KFPC Loan Agreement contains certain financial covenants which change during the term of the KFPC Loan Agreement. The financial covenants include a maximum debt to equity ratio of 3.0 to 1.0 through 2016, which will decrease to 2.0 to 1.0 in 2017 and 1.2 to 1.0 in 2018; a minimum tangible net worth requirement of $50.0 million through 2018, which will increase to $100.0 million in 2019; and a minimum interest coverage ratio of 2.5 to 1.0 commencing in 2016, which will increase to 5.0 to 1.0 in 2017. In each case, these covenants are calculated and tested on an annual basis. Formosa Petrochemical Corporation and Kraton Polymers LLC are the guarantors of the KFPC Loan Agreement with each guarantor guaranteeing 50% of the indebtedness. At December 31, 2015, KFPC was in compliance with the covenants under the KFPC Loan Agreement. For additional information regarding our KFPC Loan Agreement, see “KFPC Loan Agreement" in Note 7 Long-Term Debt to the consolidated financial statements, which is incorporated herein by reference.

Known Trends and Uncertainties

Kraton Performance Polymers, Inc. is a holding company without any operations or assets other than the operations of its subsidiaries. Cash flows from operations of our subsidiaries, cash on hand, and available borrowings under our ABL Facility are our principal sources of liquidity.

Based upon current and anticipated levels of operations, we believe that cash flows from operations of our subsidiaries, cash on hand, and borrowings available to us will be sufficient to fund our expected financial obligations, planned capital expenditures, and anticipated liquidity requirements, including working capital requirements, our investment in the KFPC joint venture, debt payments, interest payments, benefit plan contributions, and income tax obligations.

Our cash flows are subject to a number of risks and uncertainties, including, but not limited to, earnings, sensitivities to the cost of raw materials, seasonality and fluctuations in foreign currency exchange rates. Because feedstock costs generally represent a substantial portion of our cost of goods sold, in periods of rising feedstock costs, we generally consume cash in operating activities due to increases in accounts receivable and inventory costs, partially offset by increased value of accounts payable. Conversely, during periods in which feedstock costs are declining, we generate cash flow from decreases in working capital.

Going forward, there can be no assurance that our business will generate sufficient cash flow from operations or that future borrowings will be available under the ABL Facility or any new credit facilities or financing arrangements to fund liquidity needs and enable us to service our indebtedness. As of the date of this filing, $37.0 million was drawn on the ABL Facility with a remaining available borrowing capacity of $176.9 million. Our available cash and cash equivalents are held in accounts managed by third-party financial institutions and consist of cash invested in interest bearing funds and operating accounts. To date, we have not experienced any losses or lack of access to our invested cash or cash equivalents; however, we cannot provide any assurance that adverse conditions in the financial markets will not impact access to our invested cash and cash equivalents.

We made contributions of $1.8 million to our pension plan for the year ended December 31, 2015 and $7.2 million for the year ended December 31, 2014. Following the close of the Arizona Chemical Acquisition on January 6, 2016, we assumed responsibility for several additional international pension plans and one additional U.S defined benefit pension plan. As a combined company, we expect our total pension plan contributions for the year ended December 31, 2016 to be approximately $6.9 million. Our pension plan obligations are predicated on a number of factors, the primary ones being the return on our pension plan assets and the discount rate used in deriving our pension obligations. If the investment return on our pension plan assets does not meet or exceed expectations during 2016, and the discount rate decreases from the prior year, higher levels of contributions could be required in 2017 and beyond.

As of December 31, 2015, we had $51.2 million of cash and short-term investments related to foreign operations that management asserts are permanently reinvested. As a result of net operating loss carryforwards, management estimates that no additional cash tax expense would be incurred if this cash were repatriated.

Turbulence in U.S. and international markets and economies may adversely affect our liquidity and financial condition, the liquidity and financial condition of our customers, and our ability to timely replace maturing liabilities and access the capital markets to meet liquidity needs, resulting in adverse effects on our financial condition and results of operations. However, to date we have been able to access borrowings available to us in amounts sufficient to fund liquidity needs.

Our ability to pay principal and interest on our indebtedness, fund working capital, make anticipated capital expenditures, and fund our investment in the KFPC joint venture depends on our future performance, which is subject to general economic conditions and other factors, some of which are beyond our control. “See Part I, Item 1A. Risk Factors” for further discussion.

Operating Cash Flows

Net cash provided by operating activities totaled $103.8 million for the year ended December 31, 2015 and $29.9 million for the year ended December 31, 2014. This represents a net increase of $74.0 million, which was primarily driven by changes in working capital. The net change in working capital provided cash flows of $46.1 million in 2015 compared to a use of cash of $53.2 million in 2014, a period-over-period increase in cash flows of $99.3 million. The period-over-period changes are as follows:

- $63.4 million increase in cash flows associated with inventories of products, materials, and supplies, due to a decrease in inventory volumes for the year ended December 31, 2015 compared to an increase in inventory volumes for the year ended December 31, 2014. In addition, cash flows associated with inventories increased as a result of declining costs of raw material and finished goods inventories for the year ended December 31, 2015;
- $27.5 million increase in cash flows associated with trade accounts payable primarily due to the timing of payments; and
- $8.4 million net increase in cash flows due to the timing of payments of other items, including accounts receivable, related party transactions, taxes and pension costs.

Net cash provided by operating activities totaled $29.9 million for the year ended December 31, 2014 and $105.5 million for the year ended December 31, 2013. This represents a net decrease of $75.6 million, which was primarily driven by changes in working capital. The net change in working capital was a use of cash of $53.2 million in 2014 compared to a source of cash of $43.8 million in 2013; a period-over-period decline in cash flows of $97.0 million. The period-over-period changes are as follows:

- $27.1 million decrease in cash flows associated with inventories of products, materials, and supplies, largely due to increases in quantities of finished goods inventories partially offset by decreases in the cost of raw material and finished goods inventories;
- $50.3 million decrease in cash flows associated with trade accounts payable primarily due to the timing of payments and a decrease in the cost of raw materials; and
- $33.8 million net decrease in cash flows due to the timing of payments of other items, including related party transactions, taxes, and pension costs; partially offset by
- $14.2 million increase in cash flows associated with accounts receivable reflecting improved days sales outstanding and lower sales volumes.

Investing Cash Flows

Net cash used in investing activities totaled $128.7 million, $114.4 million and $88.7 million for the years ended December 31, 2015, 2014, and 2013, respectively.

Capital projects in 2015 included the following:

- $69.1 million of capital expenditures incurred by KFPC in connection with the Taiwan plant construction;
- $23.6 million related to projects to optimize the production capabilities of our manufacturing assets, which includes $9.5 million to comply with the MACT rule; and
- $18.4 million related to health, safety and environmental, including infrastructure and maintenance projects.

Capital projects in 2014 included the following:

- $44.3 million of capital expenditures incurred by KFPC in connection with the Taiwan plant construction;
- $39.0 million related to projects to optimize the production capabilities of our manufacturing assets, which includes $26.8 million to comply with the MACT rule; and
- $20.7 million related to health, safety, and environmental, including infrastructure and maintenance projects.

Expected Capital Expenditures.

We currently expect 2016 capital expenditures, excluding expenditures by the KFPC joint venture, will be approximately $100.0 million to $110.0 million. Included in this estimate is approximately $27.0 million for projects associated with our cost reset initiative, $7.0 million for projects to achieve operational synergies related to the integration of Arizona Chemical, and $50.0 million to $55.0 million for health, safety and environmental and infrastructure and maintenance projects. The remaining anticipated 2016 capital expenditures are primarily associated with projects to optimize the production capabilities of our manufacturing assets and to support our innovation platform.

We currently anticipate the total KFPC joint venture project construction cost will be approximately $200.0 million to $210.0 million; of which, 2015 capital expenditures were $69.1 million and 2016 capital expenditures will be approximately $70.0 million. The project has been funded with a combination of equity and debt financing. From the inception of the project to December 31, 2015, we and FPCC have each made equity investments of $41.6 million to KFPC. On July 17, 2014, KFPC executed the KFPC Loan Agreement in the amount of NTD 5.5 billion, or $167.5 million (converted at the December 31, 2015 exchange rate), to provide the debt portion of the project financing including funding for working capital and/or general corporate purposes. Kraton Polymers LLC and FPCC are guarantors of the KFPC Loan Agreement with each guaranteeing 50.0% of the indebtedness. See Note 7 Long-Term Debt to the consolidated financial statements for further discussion of the KFPC Loan Agreement.

Financing Cash Flows and Liquidity

Our consolidated capital structure as of December 31, 2015 was approximately 43.7% equity, 52.1% debt and 4.2% noncontrolling interest compared to approximately 52.5% equity, 42.9% debt and 4.6% noncontrolling interest as of December 31, 2014.

Net cash provided by financing activities totaled $47.1 million for the year ended December 31, 2015 compared to net cash used in financing activities of $24.4 million and $62.2 million for the years ended December 31, 2014 and 2013, respectively. In 2015, the KFPC joint venture drew $80.1 million on the KFPC Loan Agreement for construction funding partially offset by cash outflows of $31.3 million for repurchases of shares of our common stock as part of our share repurchase program approved in October 2014. In 2014, we repurchased $18.7 million in shares of our common stock as part of our share repurchase program approved in October 2014. In 2013, we repaid the $96.9 million remaining principal amount of term loans and received $41.6 million from FPCC, which represents their portion of the equity investment in the KFPC joint venture.

Other Contingencies

As a chemicals manufacturer, our operations in the United States and abroad are subject to a wide range of environmental laws and regulations at the international, national, state and local levels. These laws and regulations govern, among other things, air emissions, wastewater discharges, the use, handling and disposal of hazardous materials and wastes, occupational health and safety, including dust and noise control, site remediation programs and chemical registration, use and management.

Pursuant to these laws and regulations, our facilities are required to obtain and comply with a wide variety of environmental permits and authorizations for different aspects of their operations. Generally, many of these environmental laws and regulations are becoming increasingly stringent, and the cost of compliance with these various requirements can be expected to increase over time.

In the context of the separation in February 2001, Shell Chemicals agreed to indemnify us for specific categories of environmental claims brought with respect to matters occurring before the separation. However, the indemnity from Shell Chemicals is subject to dollar and time limitations. Coverage under the indemnity also varies depending upon the nature of the environmental claim, the location giving rise to the claim and the manner in which the claim is triggered. Therefore, if claims arise in the future related to past operations, we cannot give assurances that those claims will be covered by the Shell Chemicals' indemnity and also cannot be certain that any amounts recoverable will be sufficient to satisfy claims against us.

In connection with International Paper's divestiture of Arizona Chemical in February 2007, International Paper provided an indemnity to the buyer for specific known environmental liabilities and other environmental liabilities pertaining to former properties. At the closing of the Arizona Chemical Acquisition, Kraton was assigned the right to International Paper's indemnity for such environmental liabilities and assumed certain related obligatoins. Certain liabilities may fall outside the scope of the indemnity and therefore we cannot be certain that the indemnity will be sufficient to satisfy all environmental liabilities of Arizona Chemical.

In addition, we may in the future be subject to claims that arise solely from events or circumstances occurring after February 2001 for legacy Kraton manufacturing sites or after February 2007 for legacy Arizona Chemical manufacturing sites, which would not, in any event, be covered by the Shell Chemicals or Internatonal Paper indemnities, respectively. While we recognize that we may in the future be held liable for remediation activities beyond those identified to date, at present we are not aware of any circumstances that are reasonably expected to give rise to remediation claims that would have a material adverse effect on our results of operations or cause us to exceed our projected level of anticipated capital expenditures.

Except for the foregoing, we currently estimate that any expenses incurred in maintaining compliance with environmental laws and regulations will not materially affect our results of operations or cause us to exceed our level of anticipated capital expenditures. However, we cannot give assurances that regulatory requirements or permit conditions will not change, and we cannot predict the aggregate costs of additional measures that may be required to maintain compliance as a result of such changes or expenses.

We had no material operating expenditures for environmental fines, penalties, government imposed remedial or corrective actions during the years ended December 31, 2015, 2014, or 2013.

Off-Balance Sheet Arrangements

We are not a party to any material off-balance sheet arrangements as of December 31, 2015, other than operating leases.

Contractual Obligations

Our principal outstanding contractual obligations relate to the senior notes and related interest payments, the operating leases of some of our facilities, the minimum purchase obligations required under our KFPC joint venture agreement and other agreements, and the feedstock contracts with LyondellBasell and others to provide us with styrene, butadiene, and isoprene. The following table summarizes our contractual cash obligations as of December 31, 2015 for the periods indicated.

	Payments Due by Period						
Dollars in Millions	Total	2016	2017	2018	2019	2020	2021 and beyond
Long-term debt obligations	$350.0	$—	$—	$—	$350.0	$—	$—
Estimated interest payments on debt	83.7	25.9	25.9	25.2	5.2	1.3	0.2
Operating lease obligations	46.9	16.4	10.9	7.0	6.0	4.7	1.9
Capital lease obligation	1.6	0.1	0.2	0.2	0.2	0.2	0.8
Purchase obligations (1) (2)	2,353.5	214.2	139.7	139.4	135.0	134.5	1,590.7
Deferred income tax liabilities - noncurrent (3)	9.1	—	—	—	—	—	9.1
Uncertain tax positions, including interest and penalties (4)	4.3	—	—	—	—	—	4.3
Estimated pension obligations (5)	45.3	1.1	2.5	3.9	5.1	6.2	26.5
Total contractual cash obligations	$2,894.4	$257.7	$179.2	$175.7	$501.5	$146.9	$1,633.5

(1) Included in this line are our estimated minimum purchases required under our KFPC joint venture agreement. Due to the indefinite term of this joint venture, we have based our minimum purchases on an assumed 20 year useful life of the facility.

(2) Pursuant to operating agreements with LyondellBasell, we are currently paying the costs incurred by them in connection with the operation and maintenance of, and other services related to, our Berre, France, and Wesseling, Germany, facilities. These obligation are not included in this table.

(3) Deferred income tax liabilities may vary according to changes in tax laws, tax rates and the operating results. As a result, it is impractical to determine whether there will be a cash impact to an individual year. All noncurrent deferred income tax liabilities have been reflected in “2021 and beyond.”

(4) Due to uncertainties in the timing of the effective settlement of tax positions with the respective taxing authorities, we are unable to determine the timing of payments related to uncertain tax positions, including interest and penalties. Amounts beyond the current year are therefore reflected in “2021 and beyond.”

(5) This represents our future pension contributions utilizing the following assumptions:

- The plan was “frozen” at December 31, 2015;
- All assets at December 31, 2015 were moved into a portfolio of high quality bonds whose cash flow matches the expected cash flow of the “frozen” plan. The yield on the portfolio of bonds as of December 31, 2015 is equal to the estimated PPA effective rate at January 1, 2016. Assets were assumed to remain in such portfolio until all obligations of the plan were paid out;
- An estimated Pension Protection Act effective rate as of January 1, 2016 of 4.50%;
- All contributions are made at the latest date allowable by law; and
- All other assumptions as used in the 2015 funding actuarial valuation of the plan are met.

Impact of Inflation. Our results of operations and financial condition are presented based on historical cost. While it is difficult to accurately measure the impact of inflation due to the imprecise nature of the estimates required, we believe the effects of inflation, if any, on our results of operations and financial condition have been immaterial.

Item 7A. Quantitative and Qualitative Disclosures about Market Risk.

We are exposed to certain market risks, including risks from changes in interest rates, foreign currency exchange rates, and commodity prices that could impact our financial condition, results of operations, and cash flows. We selectively manage our exposure to these and other market risks through regular operating and financing activities as well as through the use of market risk sensitive instruments. We use such financial instruments as risk management tools and not for trading purposes. The market risk sensitive instruments that we have entered into as of December 31, 2015 consist of a series of non-deliverable forward contracts.

Interest rate risk. On January 6, 2016, we entered into a new Term Loan Facility and a new ABL Facility which bear interest at variable rates, thereby exposing us to interest rate risk. Subsequent to the close of our Term Loan Facility, we entered into a series of interest rate swaps for a portion of the forecasted Term Loan Facility balance effective in January 2017 whereby we exchanged floating for fixed rate interest payments in order to reduce exposure to interest rate volatility. However, interest rate swaps we entered may not fully mitigate our interest rate risk.

Foreign currency exchange risk. We conduct operations in many countries around the world. Our results of operations are subject to both currency transaction and currency translation risk. We incur currency transaction risk when we enter into either a purchase or sale transaction using a currency other than the local currency of the transacting entity. We are subject to currency translation risk because our financial condition and results of operations are measured and recorded in the relevant domestic currency and then translated into U.S. dollars for inclusion in our historical consolidated financial statements. We attempt to selectively manage significant exposures to potential foreign currency exchange losses based on current market conditions, future operating activities, and the associated cost in relation to the perceived risk of loss. The purpose of our foreign currency risk management activities is to minimize the risk that our cash flows from the sale and/or purchase of services and products in foreign currencies will be adversely affected by changes in exchange rates.

Periodically, we enter into foreign currency agreements to hedge or otherwise protect against fluctuations in foreign currency exchange rates. These agreements typically do not qualify for hedge accounting and gains/losses resulting from both the up-front premiums and/or settlement of the hedges at expiration of the agreements are recognized in the period in which they are incurred. In 2015, we entered into a series of foreign currency forward contracts to reduce our exposure to exchange rate volatility. These contracts were structured such that the underlying foreign currency exchange gains/losses would be offset by the mark-to-market impact of the hedging instruments and reduce the impact of foreign currency exchange movements throughout the year. The notional amounts of open foreign currency forward contracts were $24.1 million at December 31, 2015 and $46.9 million at December 31, 2014. The notional amounts of our forward contracts do not generally represent amounts exchanged by the parties, and thus are not a measure of our exposure or of the cash requirements related to these contracts. As such, cash flows related to these contracts are typically not material. The amounts exchanged are calculated by reference to the notional amounts and by other terms of the contracts, such as exchange rates.

In addition, in 2013 we entered into a series of non-deliverable forward and foreign currency option contracts to protect our net investment in various foreign subsidiaries against adverse changes in exchange rates by fixing the U.S. dollar/Euro exchange rate and the New Taiwan Dollar/Euro exchange rate. These contracts qualified for hedge accounting in accordance with ASC 815-35 “Net Investment Hedges” and typically settled weekly or monthly and all were settled at December 31, 2013. See Note 8 Fair Value Measurements, Financial Instruments and Credit Risk to the consolidated financial statements for further discussion.

We use sensitivity analysis models to measure the impact of a hypothetical 10% adverse movement of foreign currency exchange rates against the U.S. dollar. For our foreign currency transaction risk, a hypothetical 10% adverse change in the foreign currency exchange rates for all our foreign currency positions would result in a $1.7 million pre-tax loss for our net monetary assets denominated in currencies other than the respective entity's functional currency at December 31, 2015. For our foreign currency translation risk, a hypothetical 10% adverse change in the applicable average foreign currency exchange rates relative to the U.S. dollar in 2016 would negatively impact our pre-tax income by $10.5 million.

There are certain limitations inherent in the sensitivity analyses presented, primarily due to the assumption that interest rates and exchange rates change instantaneously in an equally adverse fashion. In addition, the analyses are unable to reflect the complex market reactions that normally would arise from the market shifts modeled. While this is our best estimate of the impact of the various scenarios, these estimates should not be viewed as forecasts.

Commodity price risk. We are exposed to commodity price risk due to our forward contractual purchase commitments for raw materials. Styrene, butadiene, and isoprene are primarily supplied by a portfolio of suppliers under long-term supply contracts and arrangements with various expiration dates. We are subject to future purchase commitments for these raw materials under minimum purchase contracts. Based on pricing as of December 31, 2015, a hypothetical 10.0% change in the market price for these raw materials would change our 2016 cost of goods sold by $16.6 million.

Item 8. Financial Statements and Supplementary Data.
The financial statements are set forth herein commencing on page F-5 of this report.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.
None.

Item 9A. Controls and Procedures.
Evaluation of Disclosure Controls and Procedures
An evaluation of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15 under the Securities Exchange Act of 1934) was carried out under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer. As of December 31, 2015, based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the design and operation of these disclosure controls and procedures were effective.
Management's Annual Report on Internal Control over Financial Reporting
See Management's Annual Report on Internal Control over Financial Reporting on page F-2 of the audited consolidated financial statements provided under Item 8 of this Form 10-K.
Attestation Report of the Registered Public Accounting Firm
See Report of Independent Registered Public Accounting Firm on page F-3 of the audited consolidated financial statements provided under Item 8 of this Form 10-K.
Changes in Internal Control over Financial Reporting
There has been no change in our internal control over financial reporting that occurred during the three months ended December 31, 2015 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Item 9B. Other Information.
None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance.

Information in response to this item is incorporated by reference to our Proxy Statement relating to our 2016 annual meeting of shareholders. The Proxy Statement will be filed with the SEC within 120 days after the end of the fiscal year covered by this Form 10-K pursuant to Regulation 14A under the Exchange Act.

Item 11. Executive Compensation.

Information in response to this item is incorporated by reference to our Proxy Statement relating to our 2016 annual meeting of shareholders. The Proxy Statement will be filed with the SEC within 120 days after the end of the fiscal year covered by this Form 10-K pursuant to Regulation 14A under the Exchange Act.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters.

Information in response to this item is incorporated by reference to our Proxy Statement relating to our 2016 annual meeting of shareholders. The Proxy Statement will be filed with the SEC within 120 days after the end of the fiscal year covered by this Form 10-K pursuant to Regulation 14A under the Exchange Act.

Item 13. Certain Relationships and Related Transactions, and Director Independence.

Information in response to this item is incorporated by reference to our Proxy Statement relating to our 2016 annual meeting of shareholders. The Proxy Statement will be filed with the SEC within 120 days after the end of the fiscal year covered by this Form 10-K pursuant to Regulation 14A under the Exchange Act.

Item 14. Principal Accountant Fees and Services.

Information in response to this item is incorporated by reference to our Proxy Statement relating to our 2016 annual meeting of shareholders. The Proxy Statement will be filed with the SEC within 120 days after the end of the fiscal year covered by this Form 10-K pursuant to Regulation 14A under the Exchange Act.

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) The reports of KPMG LLP, Independent Registered Public Accounting Firm
(ii) Consolidated Balance Sheets as of December 31, 2015 and 2014
(iii) Consolidated Statements of Operations—years ended December 31, 2015, 2014, and 2013
(iv) Consolidated Statements of Comprehensive Income (Loss)—years ended December 31, 2015, 2014, and 2013
(v) Consolidated Statements of Changes in Equity—years ended December 31, 2015, 2014, and 2013
(vi) Consolidated Statements of Cash Flows—years ended December 31, 2015, 2014, and 2013
(vii) Notes to consolidated financial statements
2. Exhibits
The exhibits listed on the accompanying Exhibit Index are filed as part of this report and are on file with us.
(b) Exhibits
See Item 15(a) 2 above.
(c) Financial Statement Schedule
See Schedule II.

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: February 24, 2016

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 February 24, 2016.

Signature	Title
/S/ KEVIN M. FOGARTY Kevin M. Fogarty	President, Chief Executive Officer and a Director (Principal Executive Officer)
/S/ STEPHEN E. TREMBLAY Stephen E. Tremblay	Executive Vice President and Chief Financial Officer (Principal Financial Officer)
/S/ CHRIS H. RUSSELL Chris H. Russell	Chief Accounting Officer (Principal Accounting Officer)
/S/ ANNA C. CATALANO* Anna C. Catalano	Director
/S/ STEVEN J. DEMETRIOU* Steven J. Demetriou	Director
/S/ DOMINIQUE FOURNIER* Dominique Fournier	Director
/S/ JOHN J. GALLAGHER, III* John J. Gallagher	Director
/S/ BARRY J. GOLDSTEIN* Barry J. Goldstein	Director
/S/ FRANCIS S. KALMAN* Francis S. Kalman	Director
/S/ DAN F. SMITH* Dan F. Smith	Director
/S/ KAREN A. TWITCHELL* Karen A. Twitchell	Director

*By: /S/ STEPHEN E. TREMBLAY
Stephen E. Tremblay

As attorney-in-fact

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KRATON PERFORMANCE POLYMERS, INC.
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

Management’s Annual Report on Internal Control over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control over financial reporting, as defined in Rules 13a-15(f) and 15d-15(f) of the Securities Exchange Act of 1934, as amended. Internal control over financial reporting, no matter how well designed, has inherent limitations. Therefore, even those systems determined to be effective can provide only reasonable assurance with respect to financial statement preparation and presentation. Further, because of changes in conditions, the effectiveness of internal control over financial reporting may vary over time.

Under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, we conducted an evaluation to assess the effectiveness of our internal control over financial reporting as of December : inline; FONT-FAMILY: times new roman; FONT-SIZE: 10pt">(1,272,112)

Total Stockholders' Deficit	(3,749,512)	(2,928,934)
TOTAL LIABILITIES AND STOCKHOLDERS' DEFICIT	$705,171	$1,350,447

The accompanying notes are an integral part of these financial statements.

DAIS ANALYTIC CORPORATION
STATEMENTS OF OPERATIONS

	For the Years Ended December 31, 2013	2012
REVENUE:		
Sales	$ 1,526,989	$ 3,552,440
License and royalty fees	215,606	103,640
	1,742,595	3,656,080
COST OF GOODS SOLD	1,257,418	2,434,610
GROSS MARGIN	485,177	1,221,470
OPERATING EXPENSES		
Research and development expenses, net of government grant proceeds of $180,956 and $67,240, respectively	495,175	453,927
Selling, general and administrative expenses	2,108,629	1,938,553
Impairment of equipment	2,672	62,288
TOTAL OPERATING EXPENSES	2,606,476	2,454,768
LOSS FROM OPERATIONS	(2,121,299)	(1,233,298)
OTHER EXPENSE (INCOME)		
Change in fair value of warrant liability	-	(1,888,218)
Amortization of discount on convertible note payable	-	358,555
Other income	-	(3,000)
Interest expense	179	278,091
Interest income	-	(65)
TOTAL OTHER EXPENSE (INCOME)	179	(1,254,637)
NET INCOME (LOSS)	$ (2,121,478)	$ 21,339
NET INCOME (LOSS) PER COMMON SHARE, BASIC	$ (0.04)	$ 0.00
NET INCOME (LOSS) PER COMMON SHARE, DILUTED	$ (0.04)	$ 0.00
WEIGHTED AVERAGE NUMBER OF COMMON SHARES OUTSTANDING, BASIC	57,542,454	40,022,085
WEIGHTED AVERAGE NUMBER OFCOMMON SHARES OUTSTANDING, DILUTED	57,542,454	41,279,991

The accompanying notes are an integral part of these financial statements.

DAIS ANALYTIC CORPORATION
STATEMENTS OF STOCKHOLDERS' DEFICIT

	Common Stock Shares	Common Stock Amount	Common Stock Payable	Capital in Excess of Par Value	Accumulated Deficit	Treasury Stock	Total Stockholders' Deficit
Balance, December 31, 2011	37,774,817	$ 377,749	$ -	$ 33,966,619	$ (37,973,166)	$ (1,272,112)	$ (4,900,910)
Stock based compensation	-	-	-	296,382	-	-	296,382
Revaluation of common stock issued to vendors for services	-	-	-	(105,000)	-	-	(105,000)
Issuance of common stock for cash	17,500,000	175,000	19,255	1,575,000	-	-	1,769,255
Stock issuance costs	-	-	-	(10,000)	-	-	(10,000)
Net income	-	-	-	-	21,339	-	21,339
Balance, December 31, 2012	55,274,817	$ 552,749	$ 19,255	$ 35,723,001	$ (37,951,827)	$ (1,272,112)	$ (2,928,934)
Stock based compensation				836,011			836,011
Issuance of common stock for cash	4,841,430	48,414	(19,255)	435,730			464,889
Net loss					(2,121,478)		(2,121,478)
Balance, December 31, 2013	60,116,247	$ 601,163	$ -	$ 36,994,742	$ (40,073,305)	$ (1,272,112)	$ (3,749,512)

The accompanying notes are an integral part of these financial statements.

DAIS ANALYTIC CORPORATION
STATEMENTS OF CASH FLOWS

	For the Years Ended December 31, 2013	For the Years Ended December 31, 2012
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	$ (2,121,478)	$ 21,339
Adjustments to reconcile net income (loss) to net cash and cash equivalents (used) by operating activities:		
Depreciation and amortization	106,725	61,151
Gain on sale of property and equipment	-	(3,000)
Issuance of stock options for services	19,105	-
Stock based compensation expense	816,906	296,382
Change in fair value of warrant liability	-	(1,888,218)
(Decrease) in allowance for doubtful accounts	(1,745)	(22,195)
Impairment of equipment	2,672	62,288
Write off of deferred offering costs	-	55,164
Amortization of deferred loan costs	-	30,224
Amortization of discount on convertible note payable	-	358,555
(Increase) decrease in:		
Accounts receivable	365,457	196,001
Other receivables	(109,106)	73,648
Inventory	132,573	50,465
Prepaid expenses and other assets	(1,595)	(6,237)
Increase (decrease) in:		
Accounts payable and accrued expenses	67,143	(222,251)
Accrued compensation and related benefits	178,154	89,133
Deferred revenue	(104,995)	(320,099)
Net cash used by operating activities	(650,184)	(1,167,650)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Increase in patent costs	(28,291)	(42,195)
Proceeds from sale of property and equipment	-	3,000
Purchase of property and equipment	(88,439)	(6,000)
Net cash used by investing activities	(116,730)	(45,195)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of notes payable, related party	35,000	2,050,000
Payments on notes payable, related party	-	(2,565,000)
Issuance of common stock, net of offering costs	464,889	1,759,255
Net cash provided by financing activities	499,889	1,244,255
Net increase (decrease) in cash and cash equivalents	(267,025)	31,410
Cash and cash equivalents, beginning of period	294,150	262,740
Cash and cash equivalents, end of period	$ 27,125	$ 294,150
SUPPLEMENTAL CASH FLOW INFORMATION:		

Cash paid for interest	$	179	$	533,894
NON-CASH FINANCING AND INVESTING ACTIVITIES:				
Application of proceeds due under note payable, including interest, to purchase a license and supply agreement	$	-	$	2,034,521
Revaluation of common stock issued for services	$	-	$	105,000
Loan costs paid with note payable, related party	$	-	$	15,000

The accompanying notes are an integral part of these financial statements.

Dais Analytic Corporation
Notes to Financial Statements
Years Ended December 31, 2013 and 2012

Note 1. Background Information

Dais Analytic Corporation (the "Company"), a New York corporation, has developed and is commercializing applications using its nano-structure polymer technology. The first commercial product is an energy recovery ventilator ("ERV") (cores and systems) for use in commercial Heating, Ventilating, and Air Conditioning (HVAC) applications. In addition to direct sales, the Company licenses its nano-structured polymer technology to strategic partners in the aforementioned application and is in various stages of development with regard to other applications employing its base technologies. The Company was incorporated in April of 1993 with its corporate headquarters located in Odessa, Florida.

The Company is dependent on third parties to manufacture the key components needed for our nano-structured based materials and value added products made with these materials. Accordingly, a supplier's failure to supply components in a timely manner, or to supply components that meet our quality, quantity and cost requirements or our technical specifications, or the inability to obtain alternative sources of these components on a timely basis or on terms acceptable to us, would create delays in production of our products or increase our unit costs of production. Certain of the components contain proprietary products of our suppliers, or the processes used by our suppliers to manufacture these components are proprietary. If we are required to replace any of our suppliers, while we should be able to obtain comparable components from alternative suppliers at comparable costs, this would create a delay in production.

For the year ended December 31, 2013, one customer, Multistack LLC, accounted for approximately 83% of the Company's revenue. At December 31, 2013, amounts due from this customer were approximately 63% of total accounts receivable. See Note 12 for a discussion of Multistack and the licensing agreement with MG Energy LLC. For the year ended December 31, 2012, four customers accounted for approximately 60% (four customers represented the following percentages of sales 6%, 7%, 8%, and 39%) of the Company's total revenue. At December 31, 2012, amounts due from these customers was approximately 57% of total accounts receivable.

Note 2. Going Concern and Management's Plans

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. For the year ended December 31, 2013, the Company generated a net loss of $2,121,478 and the Company has incurred significant losses since inception. As of December 31, 2013, the Company has an accumulated deficit of $40,073,305, negative working capital of $515,494 and a stockholders' deficit of $3,749,512. The Company used $650,184 and $1,167,650 of cash in operations during 2013 and 2012, respectively, which was funded by proceeds from debt and equity financings. There is no assurance that such financing will be available in the future. In view of these matters, there is substantial doubt that the Company will continue as a going concern. The Company did, however, sell 37,500,000 shares of its common stock in March 2014 for $1,500,000. The Company is currently pursuing the following sources of short and long-term working capital:

1. We are currently holding preliminary discussions with parties who are interested in licensing, purchasing the rights to, or establishing a joint venture to commercialize certain applications of our technology.
2. We are seeking growth capital from certain strategic and/or government (grant) related sources. In addition to said capital, these sources may, pursuant to any agreements that may be developed in conjunction with such funding, assist in the product definition and design, roll-out, and channel

penetration of our products.

The Company's ability to continue as a going concern is highly dependent on our ability to obtain additional sources of cash flow sufficient to fund our working capital requirements. However, there can be no assurance that the Company will be successful in its efforts to secure such cash flow. Any failure by us to timely procure additional financing or investment adequate to fund our ongoing operations, including planned product development initiatives and commercialization efforts, will have material adverse consequences on our financial condition, results of operations and cash flows.

The financial statements of the Company do not include any adjustments relating to the recoverability and classification of recorded assets, or the amounts and classifications of liabilities that might be necessary should the Company be unable to continue as a going concern.

Dais Analytic Corporation
Notes to Financial Statements
Years Ended December 31, 2013 and 2012

Note 3. Significant Accounting Policies

The significant accounting policies followed are:

Use of estimates - The preparation of 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 financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and cash equivalents – For purposes of the Statements of Cash Flows, the Company considers all highly liquid debt instruments with a maturity of three months or less to be cash equivalents. Cash and cash equivalents are maintained at financial institutions and, at times, balances may exceed federally insured limits. The Company has never experienced any losses related to these balances.

Accounts receivable - Accounts receivable consist primarily of receivables from the sale of our ERV products. The Company regularly reviews accounts receivable for any bad debts based on an analysis of the Company's collection experience, customer credit worthiness, and current economic trends. After all attempts to collect a receivable have failed, the receivable is written off against the allowance. Based on management's review of accounts receivable, we have recorded an allowance for doubtful accounts of $831 and $2,576 at December 31, 2013 and 2012.

Other receivables - Accounts receivable consist primarily of receivables from the U.S. Department of Defense and the U.S. Department of Energy ARPA-E grant program (See Note 3- Research and development expenses, and grant proceeds). The Company prepares invoices as it meets grant program milestones. Based on management's review of other receivables, management has determined that no allowance for uncollectibilty is necessary at December 31, 2013.

Inventory - Inventory consists of raw materials and work-in-process and is stated at the lower of cost, determined by first-in, first-out method, or market. Market is determined based on the net realizable value, with appropriate consideration given to obsolescence, excessive levels, deterioration and other factors. At December 31, 2013 and 2012, the Company had $78,240 and $90,124 of in-process inventory, respectively. A reserve is recorded for any inventory deemed excessive or obsolete. No reserve is considered necessary at December 31, 2013 and 2012.

Property and equipment - Property and equipment are recorded at cost. Depreciation is calculated using the straight-line method over the estimated useful lives of the assets ranging from 3 to 7 years. Depreciation expense was approximately $84,300 and $36,300 the years ended December 31, 2013 and 2012, respectively. Gains and losses upon disposition are reflected in the statement of operations in the period of disposition. Maintenance and repair expenditures are charged to expense as incurred.

Intangible assets - Identified intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. The Company's existing intangible assets consist solely of patents. Patents are amortized over their estimated useful or economic lives of 17 to 20 years. Patent amortization expense was approximately $22,400 and $24,800 for the years ended December 31, 2013 and 2012, respectively. Total patent amortization expense is estimated to be approximately $16,000 per year and $33,000 thereafter.

Long-lived assets - Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the book value of the asset may not be recoverable. The Company periodically evaluates whether events and circumstances have occurred that indicate possible impairment. When impairment indicators exist, the Company uses market quotes, if available or an estimate of the future undiscounted net cash flows of the related asset or asset group over the remaining life in measuring whether or not the asset values are recoverable. During the years ended December 31, 2013 and 2012, the Company recognized $2,672 and $62,288, respectively, in impairment costs.

Dais Analytic Corporation
Notes to Financial Statements
Years Ended December 31, 2013 and 2012

Note 3. Significant Accounting Policies (Continued)

Government Grants - Grants are recognized when there is reasonable assurance that the grant will be received and that any conditions associated with the grant will be met. When grants are received related to property and equipment, the Company reduces the basis of the assets on the balance sheet, resulting in lower depreciation expense over the life of the associated asset. Grants received related to expenses are reflected as a reduction of the associated expense in the period in which the expense is incurred.

Research and development expenses, and grant proceeds - Expenditures for research, development, and engineering of products are expensed as incurred. For the years ended December 31, 2013 and 2012, the Company incurred research and development costs of approximately $676,100 and $521,100, respectively. The Company accounts for proceeds received from government grants for research as a reduction in research and development costs. For the years ended December 31, 2013 and 2012, the Company recorded approximately $181,000 and $67,200, respectively, in grant proceeds against research and development expenses on the statements of operations.

On January 23, 2013, the U.S. Department of Defense and the U.S. Department of Energy approved an ARPA-E grant of up to $800,000 to the Company for the funding of a project to developing an energy-efficient, compact dehumidification system utilizing a polymer membrane that allows moisture to pass through. The grant is conditioned upon the Company contributing $200,000 of the proposed total project cost of $1,000,000. For the year ended December 31, 2013, the Company has incurred approximately $181,000 in expenses and recognized the same amount as a reduction to research and development expense related to this grant award.

On September 17, 2010, the U.S. Department of Energy approved a grant of up to $681,322 to the Company for the funding of a project to scale up, in size and field trial, a dehumidification system similar to the Company's NanoAir prototype. The grant is conditioned upon the Company contributing $171,500 of the proposed total project cost of $852,822. For the years ended December 31, 2012 and 2011, the Company has incurred $781 and $601,059, respectively, in expenses and recognized the same amount as a reduction to research and development expense related to this grant award. This grant was fully expended as of December 31, 2012.

In December 2010, Pasco County Florida approved a grant of $254,500 to the Company for the funding of the NanoAir product into commercialization. The grant from Pasco County requires us to pay the county 2% of the gross sales of products using a certain unique pump assembly for 5 years or for a total of $1,000,000 whichever comes first. For the years ended December 31, 2012 and 2011, the Company has incurred $66,459 and $168,095, respectively, in expenses and recognized the same amount as a reduction to research and development expense related to this grant award. This grant was fully expended as of December 31, 2012.

Stock issuance costs - Stock issuance costs are recorded as a reduction of the related proceeds through a charge to stockholders' equity.

Common stock - The Company records common stock issuances when all of the legal requirements for the issuance of such common stock have been satisfied.

Dais Analytic Corporation
Notes to Financial Statements
Years Ended December 31, 2013 and 2012

Note 3. Significant Accounting Policies (Continued)

Revenue recognition - Generally, the Company recognizes revenue for its products upon shipment to customers, provided no significant obligations remain and collection is probable.

In certain instances, our ConsERV product may carry a warranty of up to two years for all parts contained therein with the exception of the energy recovery ventilator core which may carry a warranty of up to ten years. The warranty includes replacement of defective parts. The Company has recorded an accrual of approximately $92,100 and $92,800 for future warranty expenses at December 31, 2013 and 2012, respectively, which is included in the line item for accrued expenses, other.

Revenue derived from the sale of licenses is deferred and recognized as revenue on a straight-line basis over the life of the license, or until the license arrangement is terminated. The Company recognized revenue of $189,100 and $103,640, respectively, from license agreements for the years ended December 31, 2013 and 2012. The Company recognized revenue of $26,512 and $0, respectively, from royalties for the years ended December 31, 2013 and 2012.

The Company accounts for revenue arrangements with multiple elements under the provisions of the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 605-25, "Revenue Recognition—Multiple-Element Arrangements," In order to account for these agreements, the Company must identify the deliverables included within the agreement and evaluate which deliverables represent separate units of accounting based on if certain criteria are met, including whether the delivered element has stand-alone value to the licensee. The consideration received is allocated among the separate units of accounting, and the applicable revenue recognition criteria are applied to each of the separate units.

Stock based compensation - The Company recognizes all share-based payments to employees, including grants of employee stock options, as compensation expense in the financial statements based on their fair values. That expense will be recognized over the period during which an employee is required to provide services in exchange for the award, known as the requisite service period (usually the vesting period).

The value of each grant is estimated at the grant date using the Black-Scholes option model with the following assumptions for options granted during the years ended December 31, 2013 and 2012:

	Years Ended December 31,	
	2013	2012
Dividend rate	0%	0%
Risk free interest rate	2.03% – 2.20%	0.61% – 1.04%
Expected term	10 years	5 – 6.5 years
Expected volatility	135% – 177%	123% – 125%

The basis for the above assumptions are as follows: the dividend rate is based upon the Company's history of dividends; the risk-free interest rate for periods within the expected term of the option is based on the U.S. Treasury yield curve in effect at the time of grant; the expected term was calculated based on the Company's historical pattern of options granted and the period of time they are expected to be outstanding; and expected volatility was calculated based upon historical trends in the Company's common stock, as well as a peer company's historical common stock activity.

Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Based on historical experience of forfeitures, the Company estimated forfeitures at 0% for each of the years ended December 31, 2013 and 2012.

Dais Analytic Corporation
Notes to Financial Statements
Years Ended December 31, 2013 and 2012

Note 3. Significant Accounting Policies (Continued)

Non-employee stock-based compensation - The Company's accounting policy for equity instruments issued to consultants and vendors in exchange for goods and services follows the provisions of ASC 505-50 Equity-Based Payments to Non-Employees. Stock-based compensation related to non-employees is accounted for based on the fair value of the related stock or options or the fair value of the services, whichever is more readily determinable. The measurement date for the fair value of the equity instruments issued is determined at the earlier of (i) the date at which a commitment for performance by the consultant or vendor is reached or (ii) the date at which the consultant or vendor's performance is complete. In the case of equity instruments issued to consultants, the fair value of the equity instrument is recognized over the term of the consulting agreement.

The fair value of stock options issued to consultants in 2013 was calculated using the Black-Scholes model with the following assumptions: Expected life in years: 2 years; Estimated volatility 165%; Risk-free interest rate: 0.26%; Dividend yield: 0%. The fair value of stock options issued to consultants in 2012 was calculated using the Black-Scholes model with the following assumptions: Expected life in years: 10 years; Estimated volatility 110%; Risk-free interest rate: 1.62%; Dividend yield: 0%.

Financial instruments - The Company accounts for financial instruments in accordance with FASB Accounting Standards Codification (ASC) 820 "Fair Value Measurements and Disclosures" (ASC 820). ASC 820 (as amended in May 2011) defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. ASC 820 was amended to clarify the application of existing fair value measurements and to change certain fair value measurement and disclosure requirements. Amendments that change measurement and disclosure requirements relate to (i) fair value measurement of financial instruments that are managed within a portfolio, (ii) application of premiums and discounts in a fair value measurement, and (iii) additional disclosures about fair value measurements categorized in Level 3 of the fair value hierarchy. 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 also establishes a fair value hierarchy that distinguishes between (1) market participant assumptions developed based on market data obtained from independent sources (observable inputs) and (2) an entity's own assumptions about market participant assumptions developed based on the best information available in the circumstances (unobservable inputs). The fair value hierarchy consists of three broad levels, which gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). The three levels of the fair value hierarchy are described below:

Level 1 - Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Level 2 - Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly, including quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; inputs other than quoted prices that are observable for the asset or liability (e.g., interest rates); and inputs that are derived principally from or corroborated by observable market data by correlation or other means.

Level 3 - Inputs that are both significant to the fair value measurement and unobservable.

Fair value estimates discussed herein are based upon certain market assumptions and pertinent information available to management as of December 31, 2013. The Company uses the market approach to measure fair value for its Level 1 financial assets and liabilities, which include cash equivalents of which there were none at December 31, 2013. The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets and liabilities.

Dais Analytic Corporation
Notes to Financial Statements
Years Ended December 31, 2013 and 2012

Note 3. Significant Accounting Policies (Continued)

Financial instruments (Continued)

The respective carrying value of certain on-balance sheet financial instruments approximated their fair values due to the short-term nature of these instruments. These financial instruments include cash, accounts receivable, other receivables, accounts payable, accrued compensation and accrued expenses. The fair value of the Company's related party notes payable is estimated based on current rates that would be available for debt of similar terms which is not significantly different from its stated value.

The Company's financial liabilities measured at fair value consisted of warrants as of December 31, 2012 and were valued at zero as discussed in Note 11. As of December 31, 2012 there was only one month remaining until the warrants expired, and therefore, changes to unobservable inputs would not have resulted in a significantly higher or lower fair value measurement. The fair value of the warrant liability was $1,888,218 as of December 31, 2011, which was reduced to zero through at December 31, 2012 through Other income – Changes in fair value of warrant liability.

Income taxes - Income taxes are provided for the tax effects of transactions reported in the financial statements and consist of taxes currently due plus deferred taxes resulting from temporary differences. Such temporary differences result from differences in the carrying value of assets and liabilities for tax and financial reporting purposes. The deferred tax assets and liabilities represent the future tax consequences of those differences, which will either be taxable or deductible when the assets and liabilities are recovered or settled. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized.

The Company identifies and evaluates uncertain tax positions, if any, and recognizes the impact of uncertain tax positions for which there is a less than more-likely-than-not probability of the position being upheld when reviewed by the relevant taxing authority. Such positions are deemed to be unrecognized tax benefits and a corresponding liability is established on the balance sheet. The Company has not recognized a liability for uncertain tax positions. If there were an unrecognized tax benefit, the Company would recognize interest accrued related to unrecognized tax benefits in interest expense and penalties in operating expenses. The Company's remaining open tax years subject to examination by the Internal Revenue Service generally remain open for three years from the date of filing.

Derivative Financial Instruments - The Company does not use derivative instruments to hedge exposure to cash flow, market or foreign currency risk. Terms of convertible promissory note instruments are reviewed to determine whether or not they contain embedded derivative instruments that are required under ASC 815 "Derivative and Hedging" (ASC 815) to be accounted for separately from the host contract, and recorded on the balance sheet at fair value. The fair value of derivative liabilities, if any, is required to be revalued at each reporting date, with corresponding changes in fair value recorded in current period operating results.

Freestanding warrants issued by the Company in connection with the issuance or sale of debt and equity instruments are considered to be derivative instruments and are evaluated and accounted for in accordance with the provisions of ASC 815. Pursuant to ASC 815, an evaluation of specifically identified conditions is made to determine whether fair value of warrants issued is required to be classified as equity or as a derivative liability.

Dais Analytic Corporation
Notes to Financial Statements
Years Ended December 31, 2013 and 2012

Note 3. Significant Accounting Policies (Continued)

Earnings (loss) per share - Basic income (loss) per share is computed by dividing net income (loss) attributable to common stockholders by the weighted average common shares outstanding for the period. Diluted income (loss) per share is computed giving effect to all potentially dilutive common shares. Potentially dilutive common shares may consist of incremental shares issuable upon the exercise of stock options and warrants and the conversion of notes payable to common stock. In periods in which a net loss has been incurred, all potentially dilutive common shares are considered anti-dilutive and thus are excluded from the calculation. Common share equivalents of 39,365,082 and 36,966,415 were excluded from the computation of diluted earnings per share for the years ended December 31, 2013 and 2012, respectively, because their effect is anti-dilutive.

The following sets forth the computation of basic and diluted net earnings (loss) per common share for the years ended December 31, 2013 and 2012:

	For the Years Ended December 31,			
		2013		2012
Numerator:				
Net income (loss)	$	(2,121,478)	$	21,339
Denominator:				
Weighted average basic shares outstanding		57,542,454		40,022,085
Potential shares under stock options		-		4,184,058
Less shares assumed repurchased under the treasury stock method		-		(2,926,152)
Weighted average fully diluted shares outstanding		57,542,454		41,279,991
Net income (loss) per common share – basic	$	(0.04)	$	0.00
Net income (loss) per common share – diluted	$	(0.04)	$	0.00

Recent Accounting Pronouncements.

Recent accounting pronouncements issued by the Financial Accounting Standards Board (FASB) did not or are not believed by management to have a material impact on the Company's present or future financial statements.

Note 4. Property and Equipment

Property and equipment consist of the following:

	December 31,			
		2013		2012
Furniture and fixtures	$	38,764	$	38,764
Computer equipment		64,305		66,980
Demonstration equipment		92,733		106,841
Office and lab equipment		224,174		217,523
		419,976		430,108
Less accumulated depreciation		322,995		334,551

	$	96,981	$	95,557

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Dais Analytic Corporation
Notes to Financial Statements
Years Ended December 31, 2013 and 2012

Note 5. Prepaid Expenses and Other Current Assets

Prepaid expenses and other current assets consist of the following:

	December 31, 2013	December 31, 2012
Prepaid expenses	$ 11,700	$ 10,496
Prepaid insurance	35,840	35,449
	$ 47,540	$ 45,945

Note 6. Accrued Expenses, Other

Accrued expenses, other consists of the following:

	December 31, 2013	December 31, 2012
Accrued expenses, other	$ 34,890	$ 29,946
Accrued registration rights penalty	-	5,000
Accrued warranty costs	92,100	92,829
Contractual obligation	-	13,200
	$ 126,990	$ 140,975

Note 7. Notes Payable

2011 Convertible Note

In December 2009, the Company entered into a $1,000,000 unsecured note payable with an investor which carried interest at 10% per annum. On March 22, 2011, the Company entered into a securities amendment and exchange agreement and an amended and restated convertible promissory note (collectively “Exchange Agreements”) with the investor. Pursuant to the terms and subject to the conditions set forth in the Exchange Agreements, the Company and the investor amended and restated the $1,000,000 unsecured promissory note to, among other things, add a conversion option and extend the maturity date (as amended and restated, the “2011 Convertible Note”). The initial conversion price was $0.26 per share, which was subject to adjustment for standard anti-dilution provisions. Interest in the amount of 10% per annum, commencing on December 17, 2009 and calculated on a 365 day year, and the principal amount of $1,000,000 was due in full on March 22, 2012, which was subsequently extended to May 7, 2012. The Company did not repay the 2011 Convertible Note by May 7, 2012 and on June 15, 2012, the Company entered into a forbearance agreement with the investor as discussed below.

On March 22, 2011, in connection with the above Exchange Agreements, the Company entered into amendments to existing warrant agreements with the investor to extend the terms of the existing stock purchase warrants, dated on or about December 31, 2007 and March 12, 2009, respectively, to March 22, 2016 and to provide for cashless exercise unless such warrant shares are registered for resale under a registration statement. In addition, on March 22, 2011, the Company issued an additional stock purchase warrant to the investor. Subject to the terms of the warrant, the investor may purchase 1,000,000 shares of the Company’s common stock at $0.45 per share, exercisable commencing on the earliest of the consummation of the qualified offering (as defined in the Exchange Agreements), the date of conversion of the 2011 Convertible Note in full, or the date of conversion of the Convertible Note by the investor in the greatest number of shares of the Company's common stock not to exceed 9.99% beneficial ownership of Company outstanding common stock and terminating on March 22, 2016.

Dais Analytic Corporation
Notes to Financial Statements
Years Ended December 31, 2013 and 2012

Note 7. Notes Payable (Continued)

Secured Note

Also, on March 22, 2011, the Company entered into a 10% note and warrant purchase agreement, secured convertible promissory note (the "Secured Note") and a patent security agreement ("Financing Agreements") with the investor. Pursuant to the terms and subject to the conditions set forth in the Financing Agreements, the investor provided a loan in the principal amount of $1,500,000 to the Company, which was secured by all patents, patent applications and similar protections of the Company and all rents, royalties, license fees and "accounts" with respect to such intellectual property assets. The initial conversion price was $0.26 per share, which was subject to adjustment for standard anti-dilution provisions. Interest in the amount of 10% per annum, calculated on a 365 day year, and the principal amount of $1,500,000 was due and payable on March 22, 2012, subsequently extended to May 7, 2012. The Company did not repay the Secured Note by May 7, 2012 and on June 15, 2012, the Company entered into a forbearance agreement with the investor as discussed below.

On March 22, 2011, in connection with the Financing Agreements, the Company issued a stock purchase warrant to the investor to purchase 3,000,000 shares of the Company's common stock at $0.45 per share, exercisable until March 22, 2016. The Warrant was fair valued on the date of issuance, which amounted to $1,204,787. The warrant value was recorded as a debt discount based on the relative fair value of the warrant to the total proceeds received, which amounted to $435,240. The warrant was fair valued using the Black-Scholes-Merton valuation model. In addition, the debt contained a beneficial conversion feature, which was valued at the date of issuance at $1,762,163; however, since this amount is in excess of the net value of the debt less the warrant discount, the beneficial conversion feature will be limited to $1,064,760 and recorded as a discount on the loan. The total debt discount of $1,500,000 is being amortized using the effective interest method over the 12-month term of the Secured Note. For the year ended December 31, 2012, the Company recognized $358,555 in additional expense representing amortization of this debt discount. The debt discount was fully amortized during 2012.

Forbearance Agreement

On June 15, 2012, we entered into a forbearance agreement (the "Forbearance Agreement"), with the investor. Under the Forbearance Agreement, the investor agreed to forebear from disposing of or selling any collateral secured by the patent security agreement until the earliest of: (i) July 15, 2012; (ii) two business days after our receipt of a written notice after any subsequent event of default, (iii) two business days after our receipt of a written notice that any representations, warranties or information we provided to the investor in any document or instrument in connection with the Forbearance Agreement is materially false, incomplete or misleading, (iv) two business days after our receipt of a written notice that a proceeding or other action has been commenced by any creditor against us, other than the investor (v) the date on which a court enters an order for relief or take any similar action in respect of us in an involuntary case under any applicable bankruptcy law, or (vi) the date on which a petition for relief under any applicable bankruptcy, is filed by or against us, each as further described in the Forbearance Agreement.

In connection with the Forbearance Agreement, interest on the 2011 Convertible Note and the Secured Note was increased to 20% per annum effective June 14, 2012.

On July 13, 2012 we paid in full all principal and interest due pursuant to the Secured Note and the patent security agreement was terminated. On October 29, 2012 we paid in full all principal and interest due pursuant to the 2011

Convertible Note. Upon payment of the 2011 Convertible Note the Forbearance Agreement was terminated.

Dais Analytic Corporation
Notes to Financial Statements
Years Ended December 31, 2013 and 2012

Note 7. Notes Payable (Continued)

2012 Secured Convertible Promissory Note

On July 13, 2012, the Company issued a secured convertible promissory note and patent security agreement (collectively, the "Agreements") to an investor who is a shareholder of the Company. Pursuant to the terms and subject to the conditions set forth in the Agreements, the investor provided a loan in the amount of $2,000,000 to the Company, which was secured by all current and future patents, patent applications and similar protections of the Company and all rents, royalties, license fees and "accounts" with respect to such intellectual property assets. Pursuant to the secured convertible promissory note (the "2012 Note"), interest in the amount of 6% per annum, calculated on a 365 day year, and the principal amount of $2,000,000 and accrued interest was originally due on or before October 15, 2012, subsequently extended to October 26, 2012. The investor has the right to convert principal and accrued interest into the Company's common stock at $0.26 per share. The initial conversion price may be adjusted pursuant to standard anti-dilution provisions. The proceeds of this 2012 Note were used in part to pay, in full, all outstanding principal and interest due pursuant to the Secured Note issued March 22, 2011.

The Company performed an analysis pursuant to ASC 815 in order to determine whether the embedded conversion option included in the 2012 Note was required to be accounted for separately from the host contract and recorded on the balance sheet at fair value. The Company concluded that the embedded conversion option did not meet the requirements for such classification.

Pursuant to the patent security agreement, the Company shall not, without the investor's prior consent, sell, dispose or otherwise transfer all or any portion of the Collateral, except for license grants in the ordinary course of business. In addition, the Company will take all actions reasonably necessary to prosecute to allowance applications for patents and maintain all patents, and to seek to recover damages for infringement, misappropriation or dilution of the Collateral with limited exceptions.

On October 30, 2012, the Company and MG Energy LLC, a Delaware limited liability company ("MG Energy"), entered into the License and Supply Agreement (the "Agreement"), effective October 26, 2012 as discussed in Note 12. As consideration for the Agreement, MG Energy agreed to retire the 2012 Note including all interest accrued thereon, issued by the Company to the investor, who assigned the 2012 Note to MG Energy, a company in which the investor holds a position. This retirement is nonrefundable and noncreditable. Coincident with the retirement of the 2012 Note, the related patent security agreement was terminated. In accordance with ASC Subtopic 470-50, Debt Modifications and Extinguishments, the Company determined the reacquisition price of the debt to be equal to the fair value of the debt as it was more clearly evident than the fair value of the License and Supply Agreement. The fair value of the debt approximated its carrying value and, accordingly, there was no gain or loss on the extinguishment of the debt.

Other Notes and Accrued Interest

On November 25, 2013, the Company entered into an agreement with a related party to borrow $35,000 which is due on demand and bears interest at 6%. The Company paid all interest and principal due under this note on March 7, 2014. During the year ended December 31, 2012, the Company entered into an agreement with a related party to borrow $50,000 which was due on demand and bears interest at 4%. The Company paid all interest and principal due under this note on August 1, 2012.

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Dais Analytic Corporation
Notes to Financial Statements
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Note 8. Related Party Transactions

Timothy N. Tangredi, our Chief Executive Officer and Chairman, is a founder and a member of the board of directors of Aegis BioSciences, LLC ("Aegis"). Mr. Tangredi currently owns 52% of Aegis' outstanding equity and spends approximately one to two days per month on Aegis business for which he is compensated by Aegis. Aegis has two exclusive, world-wide licenses from us under which it has the right to use and sell products containing our polymer technologies in biomedical and health care applications. As a result of a $150,000 payment made by Aegis, the first license is considered fully paid and as such no additional license revenue will be forthcoming. Pursuant to the second license Aegis made an initial one-time payment of $50,000 and is to make royalty payments of 1.5% of the net sales price it receives with respect to any personal hygiene product, surgical drape or clothing products (the latter when employed in medical and animal related fields) and license revenue it receives should Aegis grant a sublicense to a third party. To date Aegis has sold no such products nor has it received any licensing fees requiring a royalty payment be made to us. All obligations for such payments will end on the earlier of June 2, 2015 or upon the aggregate of all sums paid to us by Aegis under the agreement reaching $1 million. The term of each respective license runs for the duration of the patented technology.

The Company rents a building that is owned by two stockholders of the Company, one of which is the Chief Executive Officer. Rent expense for this building is $4,066 per month, including sales tax. The Company recognized rent expense of approximately $49,000 in each of the years ended December 31, 2013 and 2012. At December 31, 2013 and 2012, $124,917 and $82,195, respectively, were included in accounts payable for amounts owed to these stockholders for rent.

The Company also has accrued compensation due to the Chief Executive Officer and two other employees for deferred salaries earned and unpaid as of December 31, 2013 and 2012 of $1,672,893 and 1,494,739, respectively. The Company determined that a portion of the accrued payroll, $1,672,893 and $1,484,739 as of December 31, 2013 and 2012, respectively, is a long term liability, as the Company does not believe it will be repaid within the next year.

The above terms and amounts are not necessarily indicative of the terms and amounts that would have been incurred had comparable transactions been entered into with independent parties.

Note 9. Equity Transactions

Preferred Stock

The Company's Board of Directors has authorized 10,000,000 million shares of preferred stock with a par value of $0.01 to be issued in series with terms and conditions to be determined by the Board of Directors. The Company has designated 400,000 shares of Series A convertible preferred stock; 1,000,000 shares of Series B convertible preferred stock; 500,000 shares of Series C convertible preferred stock; and 1,100,000 shares of Series D convertible preferred stock. The Series A through D convertible preferred stock rank senior to the common stock as to dividends and liquidation. Each share of Series A through D convertible preferred stock is convertible into one share of common stock, except in specified circumstances as defined by the Company's Certificate of Incorporation, and is automatically converted into common stock upon the occurrence of an initial public offering that meets certain criteria. No dividend or distribution may be paid on any shares of the Company's common stock unless an equivalent dividend or distribution is paid on the Series A through D convertible preferred stock.

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Dais Analytic Corporation
Notes to Financial Statements
Years Ended December 31, 2013 and 2012

Note 9. Equity Transactions (Continued)

Common Stock

The Company's Board of Directors has authorized 200,000,000 million shares of common stock with a par value of $0.01 to be issued in series with terms and conditions to be determined by the Board of Directors.

In November of 2012, the Company issued, in connection with a private offering, 17,500,000 shares of common stock to Green Valley International Investment Management Company Limited ("GVI") at $0.10 per share for cash proceeds of $1,750,000 and the Company recorded a common stock payable for $19,255 related to 192,550 unissued shares at December 31, 2012. These shares were issued in 2013. In addition, under the terms of the private placement offering, GVI also received a warrant to purchase 4,375,000 shares of the Company's common stock with an exercise period of five years from the date of issue at an exercise price of $0.30 per share.

During the year ended December 31, 2012, the Company issued options to purchase 250,000 shares of common stock to a consultant for its services related to the private placement. The options vest immediately and may be exercised through November 30, 2022 at a price of $0.12 per share. The $26,577 value of the options which was determined using the Black-Scholes model is considered an offering cost of the private placement and, as a result, has no effect on capital in excess of par value.

In March 2013, the Company received $29,973 from GVI towards the purchase of common stock at $0.10 per share. The Company issued 492,280 shares of common stock for the $29,973 payment received in March and the $19,255 common stock payable. The Company also issued GVI warrants to purchase 123,070 shares of the Company's common stock at $0.30 per share. The warrants are exercisable for 60 months from the date of issuance.

In May 2013, the Company received $149,915 from GVI towards the purchase of common stock at $0.10 per share. The Company issued 1,499,150 shares of common stock with warrants to purchase 374,788 shares of the Company's common stock at $0.50 per share. The warrants are exercisable for 60 months from the date of issuance. All warrants issued to GVI are subject to standard anti-dilution adjustments for stock splits and other subdivisions.

In the third quarter of 2013, the Company issued, pursuant to a Stock Purchase Agreement with a limited liability company controlled by a person who subsequently was appointed a director of the Company, 2,850,000 restricted shares of the Company's common stock at a purchase price of $0.10 per share for a total of $285,000. With the issuance of the common stock, the Company issued warrants to purchase 712,500 shares of the Company's common stock at $0.50 per share. The warrants are exercisable for 60 months from the date of issuance. The warrants are subject to standard anti-dilution adjustments for stock splits and other subdivisions.

Dais Analytic Corporation
Notes to Financial Statements
Years Ended December 31, 2013 and 2012

Note 10. Stock Options and Warrants

In June 2000 and November 2009, our Board of Directors adopted, and our shareholders approved, the 2000 Incentive Compensation Plan ("2000 Plan") and the 2009 Long-Term Incentive Plan ("2009 Plan"), respectively (together the "Plans"). The Plans provide for the granting of options to qualified employees of the Company, independent contractors, consultants, directors and other individuals. The Company's Board of Directors approved and made available 11,093,882 and 15,000,000 shares of common stock to be issued pursuant to the 2000 Plan and the 2009 Plan, respectively. The 2000 Plan permits grants of options to purchase common shares authorized and approved by our Board of Directors and shareholders for issuance prior to the enactment of the 2000 Plan. The Plans permit grants of options to purchase common shares authorized and approved by the Company's Board of Directors.

The average fair value of options granted at market during 2013 and 2012 was $0.14 and $0.12 per option, respectively. The total intrinsic value of options exercised during the years ended December 31, 2013 and 2011 was $0 and $0, respectively.

The following summarizes the information relating to outstanding stock options under the Plans during 2013 and 2012:

	Common Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding at December 31, 2011	17,402,757	$ 0.32	6.66	$ 352,065
Granted	2,700,000	$ 0.12		
Forfeited or expired	(1,455,425)	$ 0.33		
Outstanding at December 31, 2012	18,647,332	$ 0.29	6.06	$ 26,345
Granted	5,468,000	0.14		
Forfeited or expired	(2,583,916)	0.14		
Outstanding at December 31, 2013	21,531,416	0.26	5.91	-
Exercisable at December 31, 2013	20,926,276	0.27	5.83	-

Stock compensation expense for options granted to both employees and consultants was approximately $836,000 for the year ended December 31, 2013 and $296,000 for the year ended December 31, 2012. The total fair value of shares vested during the years ended December 31, 2013 and 2012 was approximately $778,000 and $370,000, respectively.

As of December 31, 2013, there was approximately $54,000 of unrecognized employee stock-based compensation expense related to non vested stock options, of which $31,000, $22,000 and $1,000 is expected to be recognized for the years ended December 31, 2014, 2015 and 2016, respectively.

Dais Analytic Corporation
Notes to Financial Statements
Years Ended December 31, 2013 and 2012

Note 10. Stock Options and Warrants (Continued)

The following table represents our non vested share-based payment activity with employees for the years ended December 31, 2013 and 2012:

	Number of Options	Weighted Average Grant Date Fair Value
Nonvested options - December 31, 2011	1,094,236	$ 0.29
Granted	2,700,000	$ 0.12
Vested	(2,415,070)	$ 0.14
Forfeited	(143,611)	$ 0.32
Nonvested options - December 31, 2012	1,235,555	$ 0.16
Granted	5,468,000	0.16
Forfeited	(1,392,915)	0.24
Vested	(4,705,500)	0.17
Nonvested options - December 31, 2013	605,140	0.13

Warrants

At December 31, 2013, the Company had outstanding warrants to purchase the Company's common stock which were issued in connection with multiple financing arrangements and consulting agreements. Information relating to these warrants is summarized as follows:

Warrants	Remaining Number Outstanding	Weighted Average Remaining Life (Years)	Weighted Average Exercise Price
Warrants-Financing	7,000,000	2.22	$ 0.34
Warrants-Consulting Agreement	825,000	0.77	$ 0.30
Warrants-Note Conversions	2,302,538	1.30	$ 0.39
Warrants-Stock Purchases	7,306,128	3.42	$ 0.35
Warrants-Services	400,000	1.06	$ 0.50
Total	17,833,666		

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Years Ended December 31, 2013 and 2012

Note 11. Derivative Financial Instruments

The Company has accounted for certain warrants in accordance with ASC 815-10, Derivatives and Hedging (ASC 815-10). ASC 815-10 provides guidance for determining whether an equity-linked financial instrument (or embedded feature) is indexed to an entity's own stock. This applies to any freestanding financial instrument or embedded feature that has all the characteristics of a derivative under ASC 815-10, including any freestanding financial instrument that is potentially settled in an entity's own stock.

Due to certain adjustments that may be made to the exercise price of the warrants issued in December 2007, January 2008 and August 2008 (the "2008 Warrants"), if the Company issues or sell shares of its common stock at a price which is less than the then current warrant exercise price of the 2008 Warrants, the exercise price of the 2008 Warrants would be adjusted. These warrants have been classified as a liability as opposed to equity in accordance ASC 815-10 as it was determined that these warrants were not indexed to the Company's stock. As a result, the fair market value of these warrants is remeasured at each financial reporting period using the Black-Scholes option-pricing model with the following assumptions:

	For the Year Ended December 31, 2012	
Exercise price	$ 0.20	
Market value of stock at end of period	$ 0.12	
Expected dividend rate	N/A	
Expected volatility	29	%
Risk-free interest rate	0.04	%
Expected life in years	0.08	
Shares underlying warrants outstanding classified as liabilities	2,401,333	

At December 31, 2012, the fair value of the 2008 Warrants was determined to be zero. All of the 2008 Warrants expired in January 2013. All warrants issued by the Company other than the above noted warrants are classified as equity.

Dais Analytic Corporation
Notes to Financial Statements
Years Ended December 31, 2013 and 2012

Note 12. Deferred Revenue

The Company entered into a licensing agreement during the year ended December 31, 2003 and received an initial fee of $770,000. This fee is deferred and recognized on a straight-line basis over the life of the license agreement of 10 years. In addition, the Company received royalties of $100,000 in each of the first three years of the agreement. The Company recognized revenue of approximately $39,000 and $77,000 for this agreement during the years ended December 31, 2013 and 2012, respectively. This agreement expired in 2013.

The Company entered into a licensing agreement with a biomedical entity during the year ended December 31, 2005 and received an initial license fee of $50,000. This fee is deferred and recognized on a straight-line basis over the life of the license agreement of 7 years. The Company recognized revenue of approximately $5,000 for this agreement during each of the years ended December 31, 2013 and 2012.

On October 30, 2012, the Company and MG Energy LLC, a Delaware limited liability company (“MG Energy”) , a company in which a shareholder of the Company holds a position , entered into a License and Supply Agreement (the “Agreement”), effective October 26, 2012, pursuant to which the Company licensed certain intellectual property and improvements thereto to MG Energy, for use in the manufacture and sale of energy recovery ventilators (“ERV”) and certain other HVAC systems for installation in commercial, residential or industrial buildings in North America and South America in exchange for the cancellation of $2,034,521 of debt due to MG Energy (see Note 7). MG Energy also agreed to purchase its requirements of certain ConsERV products from the Company for MG Energy’s use, pursuant to the terms and conditions of the Agreement. MG Energy will also pay royalties, as defined, to the Company on the net sales of each product or system sold. The term of the Agreement will expire upon the last to expire of the underlying patent rights for the licensed technology.

The Company has identified all of the deliverables under the Agreement and has determined significant deliverables to be the license for the intellectual property and the supply services. In determining the units of accounting, the Company evaluated whether the license has stand alone value to MG Energy based upon consideration of the relevant facts and circumstances of the Agreement. The Company determined that the license does not have stand alone value to the licensee and, therefore, should be combined with the supply agreement as one unit of accounting. The initial payment for the license agreement will be treated as an advance payment and recognized over the performance period of the supply agreement. Royalties will be recognized as revenue when earned. The Company recognized license and royalty revenue of approximately $146,200 and $21,600 for this Agreement during the years ended December 31, 2013 and 2012, respectively.

MG Energy entered into a sublicense with Multistack, LLC. Michael Gostomski, one of the Company’s shareholders with approximately 2,500,000 shares at December 31, 2013, has an ownership interest in both MG Energy and Multistack, LLC. For the year ended December 31, 2013, Multistack, LLC, accounted for approximately 83% of the Company’s revenue. At December 31, 2013, amounts due from Multistack, LLC were approximately 63% of total accounts receivable.

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Note 13. Commitments and Contingencies

The Company has employment agreements with some of its key employees and executives. These agreements provide for minimum levels of compensation during current and future years. In addition, these agreements call for grants of stock options and for payments upon termination of the agreements.

Timothy Tangredi. The Company entered into an amended and restated employment agreement with Mr. Timothy N. Tangredi, our President, Chief Executive Officer, and director, dated as of September 14, 2011. Mr. Tangredi's employment agreement provides for an initial term of three years commencing on September 14, 2011 with the term extending on the second anniversary thereof for an additional two year period and on each subsequent anniversary of the commencement date for an additional year. Mr. Tangredi's initial base salary is $200,000. Mr. Tangredi's base salary shall be increased annually, if applicable, by a sum equal to his current base salary multiplied by one third of the percentage increase in our yearly revenue compared to our prior fiscal year revenue; provided however any annual increase in Mr. Tangredi's base salary shall not exceed a maximum of 50% for any given year. Any further increase in Mr. Tangredi's base salary shall be at the sole discretion of our board of directors or compensation committee (if applicable). Additionally, at the discretion of our board of directors and its compensation committee, Mr. Tangredi may be eligible for an annual bonus, if any, of up to 100% of his then-effective base salary, if he meets or exceeds certain annual performance goals established by the board of directors. In addition to this bonus, Mr. Tangredi may be eligible for a separate merit bonus if approved by the board of directors, for specific extraordinary events or achievements such as a sale of a division, major license or distribution arrangement or merger. Mr. Tangredi is entitled to medical, disability and life insurance, as well as four weeks of paid vacation annually, an automobile allowance, reimbursement of all reasonable business expenses, automobile insurance and maintenance, and executive conference or educational expenses.

Under his employment agreement, in addition to any other compensation which he may receive, if we complete a secondary Public Offering, Mr. Tangredi will be granted an option under our 2009 Plan to purchase up to 520,000 shares of our common stock with an exercise price equal to the fair market value per share on the date of grant. This option will become vested and exercisable in thirds, with one third vested upon grant, another third at the one-year anniversary of the grant, and another third upon the second anniversary of the grant. The option shall have a term of ten years, shall be exercisable for up to three years after termination of employment (unless termination is for cause, in which event it shall expire on the date of termination), shall have a "cashless" exercise feature, and shall be subject to such additional terms and conditions as are then applicable to options granted under such plan provided they do not conflict with the terms set forth in the agreement.

If Mr. Tangredi's employment is terminated for any reason, we will be obligated to pay him his accrued but unpaid base salary, bonus and accrued vacation pay, and any unreimbursed expenses ("Accrued Sums").

In addition to any Accrued Sums owed, if Mr. Tangredi's employment is terminated by us in the event of his disability or without cause or by Mr. Tangredi for good reason, he shall be entitled to:

(i) an amount equal to the sum of (A) the greater of 150% of the base salary then in effect or $320,000 plus (B) the cash bonus and/or merit bonus, if any, awarded for the most recent year;
(ii) health and life insurance, a car allowance and other benefits set forth in the agreement until two years following termination of employment, and thereafter to the extent required by COBRA or similar statute; and

(iii) all stock options, to the extent they were not exercisable at the time of termination of employment, shall become exercisable in full.

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Years Ended December 31, 2013 and 2012

Note 13. Commitments and Contingencies (Continued)

In addition to any Accrued Sum owed, in the event of termination upon death, Mr. Tangredi shall be entitled to (i) and (iii) above.

In addition to any Accrued Sums owed, in the event that Mr. Tangredi elects to terminate employment within one year following a change in control, he shall receive a lump sum payment equal to the sum of (a) the greater of his then current base salary or $210,000 plus (b) the cash bonus and merit bonus, if any, awarded in the most recent year. In addition, he will be entitled to (ii) and (iii) above.

The employment agreement also contains customary covenants restricting the use of our confidential information and solicitation of employees, which are similarly applicable to our other executive officers. In addition we are obligated to indemnify Mr. Tangredi for any claims made against him in connection with his employment with us, to advance indemnification expenses, and maintain his coverage under our directors' and officers' liability insurance policy.

Under the employment agreement, we and Mr. Tangredi have agreed that we will retain an independent compensation consultant, whose recommendations shall be obtained by January 31, 2012 which may modify the compensation program for Mr. Tangredi and other officers, subject to certain conditions including approval of the board of directors. Notwithstanding the recommendation and board consideration, Mr. Tangredi has the right to continue the current terms of the employment agreement. No amendment has been made as of the date of this filing.

Patricia Tangredi. In April 2011, the Company entered into an employment agreement with the Company's General Counsel, Patricia Tangredi. The employment term is for four years with automatic renewals. The agreement includes an annual base salary of $120,000 with an increase to $150,000 upon completion of a successful Secondary Public Offering of at least $10 million. The agreement also provides for a minimum of 50,000 options to be awarded annually along with other standard employment benefits.

Litigation

In the ordinary course of business, the Company may become a party to various legal proceedings generally involving contractual matters, infringement actions, product liability claims and other matters. In November 2013, the Company's Chief Operating Officer resigned from the Company. The former Chief Operating Officer alleges that the resignation was for Good Reason, as defined in the former Chief Operating Officer's employment agreement, and filed a demand for arbitration in December 2013. The former Chief Operating Officer is seeking severance pay equal to $60,000, which is 50% of her annual salary in effect as of the date of resignation. The Company intends to vigorously defend itself against these allegations and, at this stage, the Company does not have an estimate of the likelihood or the amount of any potential expense for this lawsuit.

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Years Ended December 31, 2013 and 2012

Note 14. Income Taxes

There is no current or deferred income tax expense or benefit for the years ended December 31, 2013 and 2012. The provision for income taxes is different from that which would be obtained by applying the statutory federal income tax rate to income before income taxes. The items causing this difference are as follows:

	Year ended December 31, 2013	2012
Tax (benefit) at U.S. statutory rate	$ (721,000)	$ 7,000
State income tax (benefit), net of federal benefit	(77,000)	1,000
Employee stock-based compensation	284,000	101,000
Change in warrant valuation	-	(642,000)
Amortization of debt discount	-	87,000
Other adjustments	(39,000)	(13,000)
Expiration of net operating loss	-	81,000
Change in valuation allowance	553,000	378,000
	$ -	$ -

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities are as follows:

	December 31, 2013	2012
Deferred tax assets (liabilities), current:		
Allowance for doubtful accounts	$ 2,200	$ 1,000
Stock warrant consideration and other	114,100	119,300
Accrued shareholder interest	120,600	—
Deferred license revenue	81,800	70,600
Valuation allowance	(318,700)	(190,900)
	$ —	$ —
Deferred tax assets (liabilities), noncurrent:		
Deferred license revenue	$ 662,000	$ 713,500
Depreciation	7,500	3,400
Bonus payable	108,300	108,300
Accrued deferred compensation payable	523,500	446,900
Research and development credit	45,400	—
Net operating loss carryforward	8,187,700	7,836,600
Valuation allowance	(9,534,400)	(9,108,700)
	$ —	$ —

As of December 31, 2013 and 2012, the Company had federal and state net operating loss carry-forwards totaling approximately $21,800,000 and $21,000,000, respectively, which expire through 2033. The Company has established a valuation allowance to fully reserve all deferred tax assets at December 31, 2013 and 2012 because it is more likely than not that the Company will not be able to utilize these assets. The change in the valuation allowance for the years ended December 31, 2013 and 2012 was an increase of $553,000 and $378,000, respectively.

As of December 31, 2013, the Company has not performed an IRC Section 382 study to determine the amount, if any, of its net operating losses that may be limited as a result of the ownership change percentages during 2013. However, the Company will complete the study prior to the utilization of any of its recorded net operating losses.

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Notes to Financial Statements
Years Ended December 31, 2013 and 2012

Note 15. Subsequent Events

Securities Purchase Agreement

The Company entered into a Securities Purchase Agreement (the "SPA") with an investor, Soex (Hong Kong) Industry & Investment Co., Ltd., a Hong Kong corporation (the "Investor"), pursuant to which the Company agreed to sell 37.5 million shares of the Company's common stock, $0.01 par value per share (the "Common Stock"), for $1.5 million, at $0.04 per share pursuant to Regulation S. The Company received the $1.5 million from the Investor on March 3, 2014, ahead of the March 7, 2014 deadline specified in the SPA and has issued the 37.5 million shares of Common Stock to the Investor.

The Company shall use the proceeds from the sale of the Common Stock for working capital, business development and as registered capital in an entity, which the Company is expected to be the majority owner (the "China Subsidiary"), to be incorporated in China with the Investor. Upon formation of this entity, the Investor shall provide additional funds to the China Subsidiary, to be negotiated and agreed upon between the Parties and as needed to fund the China Subsidiary including, but not limited to funds to secure and pay personnel and build the required facilities and infrastructure to sell the Company's ConsERV and Aqualyte materials products in China.

Litigation

In March 2014, the Company received notice of a lawsuit against the Company and one of its OEM customers for damages in connection with the installation of equipment by a contractor involved in a construction project. The contractor makes claims for breach or warranties, negligence and products liability. In the complaint, the contractor alleges that it paid $180,000 to the general contractor of the project for damages, including consequential and incidental damages, allegedly caused by equipment manufactured by the Company and its customer. The Company intends to vigorously defend itself against these allegations and, at this stage, the Company does not have an estimate of the likelihood or the amount of any potential expense for this lawsuit.

No other material events have occurred subsequent to December 31, 2013 that require recognition or disclosure in these financial statements.