

Kraton Performance Polymers, Inc.
Form 10-Q
May 02, 2013
[Table of Contents](#)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2013

.. **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)

Edgar Filing: Kraton Performance Polymers, Inc. - Form 10-Q

Delaware
(State or other jurisdiction of
incorporation or organization)

15710 John F. Kennedy Blvd.

Suite 300

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

20-0411521
(I.R.S. Employer

Identification No.)

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

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

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

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

Large accelerated filer:

Accelerated filer:

Non-accelerated filer:

Smaller reporting company:

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

Number of shares of Kraton Performance Polymers, Inc. Common Stock, \$0.01 par value, outstanding as of April 26, 2013: 32,528,011.

Table of Contents

Index to Quarterly Report
on Form 10-Q for
Quarter Ended March 31, 2013

PART I. FINANCIAL INFORMATION		Page
Item 1	<u>Condensed Consolidated Financial Statements (Unaudited)</u>	6
	<u>Condensed Consolidated Balance Sheets as of March 31, 2013 and December 31, 2012</u>	6
	<u>Condensed Consolidated Statements of Operations for the three months ended March 31, 2013 and 2012</u>	7
	<u>Condensed Consolidated Statements of Comprehensive Income (Loss) for the three months ended March 31, 2013 and 2012</u>	8
	<u>Condensed Consolidated Statements of Changes in Equity for the three months ended March 31, 2013 and 2012</u>	9
	<u>Condensed Consolidated Statements of Cash Flows for the three months ended March 31, 2013 and 2012</u>	10
	<u>Notes to the Condensed Consolidated Financial Statements</u>	11
Item 2	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	32
Item 3	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	44
Item 4	<u>Controls and Procedures</u>	44
PART II. OTHER INFORMATION		
Item 1	<u>Legal Proceedings</u>	45
Item 1A	<u>Risk Factors</u>	45
Item 6	<u>Exhibits</u>	46
	<u>Signatures</u>	47

Table of Contents

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

Some of the statements in this Quarterly Report on Form 10-Q under the headings "Condensed Consolidated Financial Statements" and "Management's Discussion and Analysis of Financial Condition and Results of Operations" and elsewhere contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. We may also make written or oral forward-looking statements in our periodic reports on Forms 10-K, 10-Q and 8-K, in press releases and other written materials and in oral statements made by our officers, directors or employees to third parties. Statements that are not historical facts, including statements about our beliefs and expectations, are forward-looking statements. Forward-looking statements are often characterized by the use of words such as "believes," "estimates," "expects," "projects," "may," "intends," "plans" or "anticipates," or by discussions of strategy, plans or intentions; anticipated benefits of or performance of our products; beliefs regarding opportunities for new, high-margin applications and other innovations; adequacy of cash flows to fund our working capital requirements; our investment in the joint venture with FPCC; debt payments, interest payments, capital expenditures, benefit plan contributions, and income tax obligations; our anticipated 2013 capital expenditures, including the amount of expenditures related to the semi-works facility, compliance with the MACT rule, health, safety and environmental and infrastructure and maintenance projects, projects to optimize the production capabilities of our manufacturing assets and to support our innovation platform; our ability to meet conditions required to ensure full access to our senior secured credit facilities; expectations regarding availability under our loan agreement; expectations regarding our counterparties' ability to perform, including with respect to trade receivables; estimates regarding the tax expense of repatriating certain cash and short-term investments related to foreign operations; expectations regarding high-margin applications; our ability to realize certain deferred tax assets and our beliefs with respect to tax positions; our plans and expectations regarding our planned Asia expansion project; estimates related to the useful lives of certain assets for tax purposes; expectations regarding our pension contributions for fiscal year 2013; estimates or expectations related to monomer costs, ending inventory levels and related estimated charges; the outcome and financial impact of legal proceedings; expectations regarding the spread between FIFO and ECRC in future periods; and projections regarding environmental costs and capital expenditures and related operational savings. Such forward-looking statements involve known and unknown risks, uncertainties, and other important factors that could cause the actual results, performance or our achievements, or industry results, to differ materially from historical results, any future results, or performance or achievements expressed or implied by such forward-looking statements. There are a number of risks and uncertainties that could cause our actual results to differ materially from the forward-looking statements contained in this report. Further description of these risks and uncertainties and other important factors are set forth in this report, in our latest Annual Report on Form 10-K, including but not limited to Part I, Item 1A. Risk Factors and Part II, Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations therein, and in our other filings with the Securities and Exchange Commission, and include, but are not limited to, risks related to:

conditions in the global economy and capital markets;

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

the failure of our raw materials suppliers to perform their obligations under long-term supply agreements, or our inability to replace or renew these agreements when they expire;

limitations in the availability of raw materials we need to produce our products in the amounts or at the prices necessary for us to effectively and profitably operate our business;

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

competition in our end use markets by other producers of styrenic block copolymers and by producers of products that can be substituted for our products;

our ability to produce and commercialize technological innovations;

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

Table of Contents

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

seasonality in our business, particularly in our Paving and Roofing end use market;

our substantial indebtedness, which could adversely affect our financial condition and prevent us from fulfilling our obligations under the loan agreement and the senior notes;

financial and operating constraints related to our indebtedness;

the inherently hazardous nature of chemical manufacturing;

product liability claims and other lawsuits arising from environmental damage, personal injuries, other damages associated with chemical manufacturing or our products;

political, economic and local business risks in the various countries in which we operate;

health, safety and environmental laws, including laws that govern our employees' exposure to chemicals deemed harmful to humans;

regulation of our company or our customers, which could affect the demand for our products or result in increased compliance and other costs;

customs, international trade, export control, antitrust, zoning and occupancy and labor and employment laws that could require us to modify our current business practices and incur increased costs;

fluctuations in currency exchange rates;

we may have additional tax liabilities;

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

our relationship with our employees;

loss of key personnel or our inability to attract and retain new qualified personnel;

the fact that we generally do not enter into long-term contracts with our customers;

Edgar Filing: Kraton Performance Polymers, Inc. - Form 10-Q

a decrease in the fair value of our pension assets could require us to materially increase future funding requirements of the pension plan;

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

Delaware law and some provisions of our organizational documents that make a takeover of our company more difficult;

our expectation that we will not pay dividends for the foreseeable future; and

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

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

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

Table of Contents

Presentation of Financial Statements

The terms Kraton, our company, we, our, ours and us as used in this report refer collectively to Kraton Performance Polymers, Inc. and its consolidated subsidiaries. This Form 10-Q includes financial statements and related notes that present the condensed consolidated financial position, results of operations, comprehensive income, and cash flows of Kraton and its subsidiaries. Kraton is a holding company whose only material asset is its investment in its wholly owned subsidiary, Kraton Polymers LLC. Kraton Polymers LLC and its subsidiaries own all of our consolidated operating assets.

Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Condensed Consolidated Financial Statements.****KRATON PERFORMANCE POLYMERS, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(Unaudited)****(In thousands, except par value)**

	March 31, 2013	December 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 136,118	\$ 223,166
Receivables, net of allowances of \$485 and \$401	153,747	124,635
Inventories of products	349,788	340,323
Inventories of materials and supplies	10,469	10,331
Deferred income taxes	7,779	7,869
Other current assets	26,952	28,363
Total current assets	684,853	734,687
Property, plant and equipment, less accumulated depreciation of \$320,521 and \$311,779	378,542	381,205
Intangible assets, less accumulated amortization of \$71,026 and \$68,531	61,539	63,393
Investment in unconsolidated joint venture	12,989	13,582
Debt issuance costs	10,533	10,846
Deferred income taxes	67	79
Other long-term assets	26,226	25,397
Total assets	\$ 1,174,749	\$ 1,229,189
LIABILITIES AND EQUITY		
Current liabilities:		
Current portion of long-term debt	\$ 0	\$ 15,074
Accounts payable-trade	107,960	99,167
Other payables and accruals	32,439	50,978
Deferred income taxes	511	513
Due to related party	22,421	16,080
Total current liabilities	163,331	181,812
Long-term debt, net of current portion	391,104	432,943
Deferred income taxes	20,787	22,273
Other long-term liabilities	101,488	99,946
Total liabilities	676,710	736,974
Commitments and contingencies (note 10)		
Equity:		
Kraton stockholders' equity:		
Preferred stock, \$0.01 par value; 100,000 shares authorized; none issued	0	0

Edgar Filing: Kraton Performance Polymers, Inc. - Form 10-Q

Common stock, \$0.01 par value; 500,000 shares authorized; 32,528 shares issued and outstanding at March 31, 2013; 32,277 shares issued and outstanding at December 31, 2012	325	323
Additional paid in capital	357,788	354,957
Retained earnings	167,697	171,445
Accumulated other comprehensive loss	(43,169)	(34,510)
Total Kraton stockholders' equity	482,641	492,215
Noncontrolling interest	15,398	0
Total equity	498,039	492,215
Total liabilities and equity	\$ 1,174,749	\$ 1,229,189

See Notes to Condensed Consolidated Financial Statements

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

	Three months ended March 31,	
	2013	2012
Sales revenue	\$ 340,107	\$ 408,313
Cost of goods sold	280,196	332,794
Gross profit	59,911	75,519
Operating expenses:		
Research and development	7,913	7,560
Selling, general and administrative	26,114	26,463
Depreciation and amortization	15,098	15,849
Total operating expenses	49,125	49,872
Earnings of unconsolidated joint venture	134	137
Interest expense, net	13,298	6,699
Income (loss) before income taxes	(2,378)	19,085
Income tax expense	1,446	2,732
Consolidated net income (loss)	(3,824)	16,353
Net loss attributable to noncontrolling interest	(76)	0
Net income (loss) attributable to Kraton	\$ (3,748)	\$ 16,353
Earnings (loss) per common share:		
Basic	\$ (0.12)	\$ 0.51
Diluted	\$ (0.12)	\$ 0.50
Weighted average common shares outstanding:		
Basic	32,062	31,908
Diluted	32,062	32,248

See Notes to Condensed Consolidated Financial Statements.

Table of Contents

KRATON PERFORMANCE POLYMERS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited)

(In thousands)

	Three months ended March 31,	
	2013	2012
Net income (loss) attributable to Kraton	\$ (3,748)	\$ 16,353
Other comprehensive income (loss):		
Foreign currency translation adjustments, net of tax of \$0	(9,271)	10,326
(Increase) decrease in unrealized loss on interest rate swaps, net of tax of \$0	837	(117)
Unrealized loss of net investment hedge, net of tax of \$0	(225)	0
Other comprehensive income (loss), net of tax	(8,659)	10,209
Comprehensive income (loss) attributable to Kraton	(12,407)	26,562
Comprehensive income attributable to noncontrolling interest	224	0
Consolidated comprehensive income (loss)	\$ (12,183)	\$ 26,562

See Notes to Condensed Consolidated Financial Statements

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

	Common Stock	Additional Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Kraton Stockholders Equity	Noncontrolling Interest	Total Equity
Balance at December 31, 2011	\$ 321	\$ 347,455	\$ 187,636	\$ (17,618)	\$ 517,794	\$ 0	\$ 517,794
Net income	0	0	16,353	0	16,353	0	16,353
Other comprehensive income	0	0	0	10,209	10,209	0	10,209
Exercise of stock options	1	259	0	0	260	0	260
Non-cash compensation related to equity awards	0	1,880	0	0	1,880	0	1,880
Balance at March 31, 2012	\$ 322	\$ 349,594	\$ 203,989	\$ (7,409)	\$ 546,496	\$ 0	\$ 546,496
Balance at December 31, 2012	\$ 323	\$ 354,957	\$ 171,445	\$ (34,510)	\$ 492,215	\$ 0	\$ 492,215
Net loss	0	0	(3,748)	0	(3,748)	(76)	(3,824)
Other comprehensive income (loss)	0	0	0	(8,659)	(8,659)	300	(8,359)
Consolidation of variable interest entity	0	0	0	0	0	15,174	15,174
Exercise of stock options	2	308	0	0	310	0	310
Non-cash compensation related to equity awards	0	2,523	0	0	2,523	0	2,523
Balance at March 31, 2013	\$ 325	\$ 357,788	\$ 167,697	\$ (43,169)	\$ 482,641	\$ 15,398	\$ 498,039

See Notes to Condensed Consolidated Financial Statements

Table of Contents**KRATON PERFORMANCE POLYMERS, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)****(In thousands)**

	Three months ended March 31,	
	2013	2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Consolidated net income (loss)	\$ (3,824)	\$ 16,353
Adjustments to reconcile consolidated net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	15,098	15,849
Amortization of debt premium	(38)	0
Amortization of debt issuance costs	5,781	668
(Gain) loss on property, plant and equipment	(16)	358
Earnings from unconsolidated joint venture, net of dividends received	288	263
Deferred income tax benefit	(921)	(412)
Share-based compensation	2,523	1,880
<i>Decrease (increase) in:</i>		
Accounts receivable	(32,078)	(42,411)
Inventories of products, materials and supplies	(14,148)	41,958
Other assets	(588)	(3,342)
<i>Increase (decrease) in:</i>		
Accounts payable-trade	12,926	13,124
Other payables and accruals	(15,767)	(2,402)
Other long-term liabilities	2,196	251
Due to related party	7,794	13,939
Net cash provided by (used in) operating activities	(20,774)	56,076
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase of property, plant and equipment	(14,455)	(8,786)
Purchase of software	(707)	(1,643)
Settlement of net investment hedge	(2,225)	0
Net cash used in investing activities	(17,387)	(10,429)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from debt	40,000	101,250
Repayments of debt	(96,875)	(1,875)
Capital lease payments	(950)	0
Contribution from noncontrolling interest	15,174	0
Proceeds from the exercise of stock options	310	260
Debt issuance costs	(3,117)	(2,728)
Net cash provided by (used in) financing activities	(45,458)	96,907
Effect of exchange rate differences on cash	(3,429)	2,343
Net increase (decrease) in cash and cash equivalents	(87,048)	144,897
Cash and cash equivalents, beginning of period	223,166	88,579

Edgar Filing: Kraton Performance Polymers, Inc. - Form 10-Q

Cash and cash equivalents, end of period	\$ 136,118	\$ 233,476
Supplemental disclosures:		
Cash paid during the period for income taxes, net of refunds received	\$ 4,643	\$ 1,281
Cash paid during the period for interest, net of capitalized interest	\$ 13,639	\$ 9,976
Capitalized interest	\$ 961	\$ 483
Supplemental non-cash disclosures:		
Non-cash capital accruals	\$ 3,495	\$ 199

See Notes to Condensed Consolidated Financial Statements

Table of Contents

KRATON PERFORMANCE POLYMERS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. General

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

Basis of Presentation. The accompanying unaudited condensed consolidated financial statements presented herein are for us and our consolidated subsidiaries, each of which is a wholly-owned subsidiary, except our 50% investment in our joint venture, Kraton Formosa Polymers Corporation (KFPC), located in Mailliao, Taiwan. KFPC is a variable interest entity for which we have determined that we are the primary beneficiary and, therefore, have consolidated into our financial statements. Our 50% investment in our joint venture located in Kashima, Japan is accounted for under the equity method of accounting. All significant intercompany transactions have been eliminated. These interim financial statements should be read in conjunction with the consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2012 and reflect all normal recurring adjustments that are, in the opinion of management, necessary to fairly present our results of operations and financial position. Amounts reported in our Condensed Consolidated Statements of Operations are not necessarily indicative of amounts expected for the respective annual periods or any other interim period, in particular due to the effect of seasonal changes and weather conditions that typically affect our sales into our Paving and Roofing end use market.

Our significant accounting policies have been disclosed in Note 1 *Description of Business, Basis of Presentation and Significant Accounting Policies* in our most recent Annual Report on Form 10-K. There have been no changes to the policies disclosed therein. The accompanying unaudited condensed consolidated financial statements we present in this report have been prepared in accordance with those policies.

Use of Estimates. The preparation of condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates

Table of Contents

and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant items subject to such estimates and assumptions include the useful lives of fixed assets; allowances for doubtful accounts and sales returns; the valuation of derivatives, deferred tax assets, property, plant and equipment, inventory, investments and share-based compensation; and liabilities for employee benefit obligations, asset retirement obligations (ARO), income tax uncertainties and other contingencies.

Income Tax in Interim Periods. We conduct operations in separate legal entities in different jurisdictions. As a result, income tax amounts are reflected in these condensed consolidated financial statements for each of those jurisdictions. Tax laws and tax rates vary substantially in these jurisdictions and are subject to change based on the political and economic climate in those countries. We file our tax returns in accordance with our interpretations of each jurisdiction's tax laws. We record our tax provision or benefit on an interim basis using the estimated annual effective tax rate. This rate is applied to the current period ordinary income or loss to determine the income tax provision or benefit allocated to the interim period.

Losses from jurisdictions for which no benefit can be realized and the income tax effects of unusual and infrequent items are excluded from the estimated annual effective tax rate. Valuation allowances are provided against the future tax benefits that arise from the losses in jurisdictions for which no benefit can be realized. The effects of unusual and infrequent items are recognized in the impacted interim period as discrete items.

The estimated annual effective tax rate may be significantly affected by nondeductible expenses and by our projected earnings mix by tax jurisdiction. Adjustments to the estimated annual effective income tax rate are recognized in the period during which such estimates are revised.

We have established valuation allowances against a variety of deferred tax assets, including net operating loss carryforwards, foreign tax credits and other income tax credits. Valuation allowances take into consideration our ability to realize these deferred tax assets and reduce the value of such assets to the amount that is deemed more likely than not to be recoverable. Our ability to realize these deferred tax assets is dependent on achieving our forecast of future taxable operating income over an extended period of time. We review our forecast in relation to actual results and expected trends on a quarterly basis. Failure to achieve our operating income targets may change our assessment regarding the recoverability of our net deferred tax assets and such change could result in a valuation allowance being recorded against some or all of our net deferred tax assets. A change in our valuation allowance would impact our income tax expense/benefit and our stockholders' equity and could have a significant impact on our results of operations or financial condition in future periods.

2. New Accounting Pronouncements

Adoption of Accounting Standards

We have implemented all new accounting pronouncements that are in effect and that management believes would materially impact our financial statements. Management does not believe that there are any other new accounting pronouncements that have been issued that may have a material impact on our financial position or results of operations.

3. Share-Based Compensation

We account for share-based awards under the provisions of ASC 718, *Compensation Stock Compensation*, which established the accounting for share-based awards exchanged for employee services. Accordingly, share-based compensation cost is measured at the grant date based on the fair value of the award and we expense these costs using the straight-line method over the requisite service period. Share-based compensation expense was \$2.5 million and \$1.9 million for the three months ended March 31, 2013 and 2012, respectively. We record these costs in selling, general and administrative expenses.

Table of Contents**4. Detail of Certain Balance Sheet Accounts**

	March 31, 2013	December 31, 2012
	(In thousands)	
<i>Inventories of products:</i>		
Finished products	\$ 264,506	\$ 260,510
Work in progress	6,258	6,759
Raw materials	79,024	73,054
Total inventories of products	\$ 349,788	\$ 340,323
<i>Other payables and accruals:</i>		
Employee related	\$ 9,918	\$ 13,423
Income taxes payable	758	3,638
Other	21,763	33,917
Total other payables and accruals	\$ 32,439	\$ 50,978
<i>Other long-term liabilities:</i>		
Pension and other postretirement benefits	\$ 85,315	\$ 84,005
Other	16,173	15,941
Total other long-term liabilities	\$ 101,488	\$ 99,946
<i>Accumulated other comprehensive loss:</i>		
Foreign currency translation adjustments	\$ 17,685	\$ 26,956
Net unrealized loss on interest rate swaps	0	(837)
Net unrealized loss on net investment hedge	(1,661)	(1,436)
Pension liability	(59,193)	(59,193)
Total accumulated other comprehensive loss	\$ (43,169)	\$ (34,510)

5. Earnings Per Share (EPS)

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

Diluted EPS is computed by dividing net income attributable to Kraton by the diluted weighted-average number of shares outstanding during the period and, accordingly, reflects the potential dilution that could occur if securities or other agreements to issue common stock, such as stock options, were exercised, settled or converted into common stock and were dilutive. The diluted weighted-average number of shares used in our diluted EPS calculation is determined using the treasury stock method.

Unvested awards of share-based payments with rights to receive dividends or dividend equivalents, such as our restricted stock awards are considered to be participating securities, and therefore, the two-class method is used for purposes of calculating EPS. Under the two-class method, a portion of net income is allocated to these participating securities and is excluded from the calculation of EPS allocated to common stock. Our restricted stock awards are subject to forfeiture and restrictions on transfer until vested and have identical voting, income and distribution rights to the unrestricted common shares outstanding.

The computation of diluted EPS excludes the effect of the potential exercise of stock options that are anti-dilutive. The number of stock options excluded from the computation was 1,643,950 and 728,708 for the three months ended March 31, 2013 and 2012, respectively. The weighted average restricted share units and performance share units of 37,921 and 20,276, respectively, are not included as a component of diluted EPS for the three months ended March 31, 2013, as they are anti-dilutive.

Table of Contents

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

	Three months ended March 31, 2013			Three months ended March 31, 2012		
	Net Loss Attributable to Kraton (In thousands, except per share data)	Weighted Average Shares Outstanding	Loss Per Share	Net Income Attributable to Kraton (In thousands, except per share data)	Weighted Average Shares Outstanding	Earnings Per Share
<i>Basic:</i>						
As reported	\$ (3,748)	32,356		\$ 16,353	32,141	
Amounts allocated to unvested restricted shares	34	(294)		(119)	(233)	
Amounts available to common stockholders	(3,714)	32,062	\$ (0.12)	16,234	31,908	\$ 0.51
<i>Diluted:</i>						
Amounts allocated to unvested restricted shares						