

Kraton Corp
Form 10-Q
July 27, 2017

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

FORM 10-Q

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

For the quarterly period ended June 30, 2017

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

Commission File Number 001-34581

Kraton Corporation
(Exact Name of Registrant as Specified in its Charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

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

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

281-504-4700

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

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

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

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

Large accelerated filer: Accelerated filer:

Non-accelerated filer: Smaller reporting company:

Emerging growth company:

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the

Edgar Filing: Kraton Corp - Form 10-Q

Exchange Act. "

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

Number of shares of Kraton Corporation Common Stock, \$0.01 par value, outstanding as of July 24, 2017: 31,210,041.

Index to Quarterly Report
on Form 10-Q for
Quarter Ended June 30, 2017

PART I. FINANCIAL INFORMATION	Page
<u>Report of KPMG LLP, Independent Registered Public Accounting Firm</u>	<u>4</u>
<u>Item 1 Condensed Consolidated Financial Statements (Unaudited)</u>	<u>5</u>
<u>Condensed Consolidated Balance Sheets as of June 30, 2017 and December 31, 2016</u>	<u>5</u>
<u>Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2017 and 2016</u>	<u>6</u>
<u>Condensed Consolidated Statements of Comprehensive Income for the three and six months ended June 30, 2017 and 2016</u>	<u>7</u>
<u>Condensed Consolidated Statements of Changes in Equity for the six months ended June 30, 2017 and 2016</u>	<u>8</u>
<u>Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2017 and 2016</u>	<u>9</u>
<u>Notes to the Condensed Consolidated Financial Statements</u>	<u>10</u>
<u>Item 2 Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>41</u>
<u>Item 3 Quantitative and Qualitative Disclosures about Market Risk</u>	<u>58</u>
<u>Item 4 Controls and Procedures</u>	<u>58</u>
PART II. OTHER INFORMATION	
<u>Item 1 Legal Proceedings</u>	<u>59</u>
<u>Item 1A Risk Factors</u>	<u>59</u>
<u>Item 2 Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>60</u>
<u>Item 3 Defaults Upon Senior Securities</u>	<u>60</u>
<u>Item 4 Mine Safety Disclosures</u>	<u>60</u>
<u>Item 5 Other Information</u>	<u>60</u>
<u>Item 6 Exhibits</u>	<u>61</u>
<u>Signatures</u>	<u>62</u>

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING INFORMATION

Some of the statements and information in this Quarterly Report on Form 10-Q contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. We may also make written forward-looking statements in our reports on Forms 10-K, 10-Q and 8-K, in press releases and other written materials as well as 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 identified by words such as “outlook,” “believes,” “estimates,” “expects,” “projects,” “may,” “intends,” “plans,” “anticipates,” “foresees,” “future” or similar expressions or by discussions of strategy, plans or intentions. However, the absence of these words or similar expressions does not mean that a statement is not forward-looking. All statements that address operating performance, events or developments that we expect or anticipate will occur in the future, including statements related to: our ability to successfully identify, complete and integrate potential acquisitions, including our acquisition of Arizona Chemical Holdings Corporation (now known as AZ Chem Holdings LP, “Arizona Chemical”), and realize expected synergies and cost savings related thereto; our ability to generate sufficient cash flows to fund our working capital requirements and service our outstanding indebtedness; the availability, terms and deployment of indebtedness and equity capital, including our ability to fully access our senior secured credit facilities; our beliefs regarding the strengthening relationships with our customers; the anticipated benefits of, or performance of, our products; our beliefs regarding opportunities for new, differentiated applications and other innovations; our estimates and expectations related to the cost and availability of raw materials, ending inventory levels and related changes; our expectations regarding our counterparties’ ability to perform their obligations under operating, service, supply and other similar agreements and our ability to replace or renew such agreements when they expire; our expectations regarding our investments in joint ventures, including Formosa Petrochemical Corporation (“FPCC”); our anticipated capital expenditures, health, safety, environmental, security and infrastructure and maintenance costs, projects to optimize the production capabilities of our manufacturing assets and to support our innovation platform; our expectations regarding effective tax rates and positions; our ability to realize deferred tax assets and expected expenses of repatriating cash and short-term investments related to foreign operations and/or indebtedness; our future reliance on third party providers, in particular LyondellBasell Industries, for operating and other services; our ability to address or manage corruption concerns in certain locations in which we operate; our ability to address and manage cyber-security risks; our ability to protect our intellectual property, on which our business is substantially dependent; our expectations regarding future dividend payments; and our expectations regarding the impact of general economic conditions on our business are forward-looking statements.

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, 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 (the “SEC”). 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. In addition, to the extent any inconsistency or conflict exists between the information included in this report and the information included in our prior reports and other filings with the SEC, the information contained in this report updates and supersedes such information.

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 in light of new information or future events.

Presentation of Financial Statements

The terms “Kraton,” “our company,” “we,” “our,” “ours” and “us” as used in this report refer collectively to Kraton Corporation and its consolidated subsidiaries.

Edgar Filing: Kraton Corp - Form 10-Q

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. Kraton Corporation is a holding company whose only material asset is its investment in its wholly owned subsidiary, Kraton Polymers LLC. Kraton Polymers LLC and its subsidiaries own all of our consolidated operating assets.

Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders

Kraton Corporation:

We have reviewed the accompanying condensed consolidated balance sheet of Kraton Corporation and subsidiaries (the "Company") as of June 30, 2017, the related condensed consolidated statements of operations, and comprehensive income, for the three and six month periods ended June 30, 2017 and 2016, and the related condensed consolidated statements of changes in equity, and cash flows for the six-month periods ended June 30, 2017 and 2016. These condensed consolidated financial statements are the responsibility of the Company's management.

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

Accordingly, we do not express such an opinion.

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

We have previously audited, in accordance with standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheet of Kraton Corporation and subsidiaries as of December 31, 2016, and the related consolidated statements of operations, comprehensive income (loss), changes in equity, and cash flows for the year then ended (not presented herein); and in our report dated February 28, 2017, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 2016 is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

/s/ KPMG LLP

Houston, Texas

July 27, 2017

PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements.

KRATON CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except par value)

	June 30, 2017 (unaudited)	December 31, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 128,712	\$ 121,749
Receivables, net of allowances of \$1,080 and \$814	252,597	200,860
Inventories of products	394,820	327,996
Inventories of materials and supplies	23,858	22,392
Prepaid expenses	38,251	35,851
Other current assets	48,437	37,658
Total current assets	886,675	746,506
Property, plant, and equipment, less accumulated depreciation of \$467,992 and \$411,418	935,208	906,722
Goodwill	772,564	770,012
Intangible assets, less accumulated amortization of \$171,607 and \$144,946	423,043	439,198
Investment in unconsolidated joint venture	11,688	11,195
Debt issuance costs	2,926	3,511
Deferred income taxes	8,055	6,907
Other long-term assets	22,367	22,594
Total assets	\$3,062,526	\$ 2,906,645
LIABILITIES AND EQUITY		
Current liabilities:		
Current portion of long-term debt	\$33,521	\$ 41,825
Accounts payable-trade	150,186	150,081
Other payables and accruals	123,705	130,398
Due to related party	19,676	14,669
Total current liabilities	327,088	336,973
Long-term debt, net of current portion	1,777,453	1,697,700
Deferred income taxes	215,597	211,396
Other long-term liabilities	175,577	170,339
Total liabilities	2,495,715	2,416,408
Commitments and contingencies (note 10)		
Equity:		
Kraton stockholders' equity:		
Preferred stock, \$0.01 par value; 100,000 shares authorized; none issued	—	—
Common stock, \$0.01 par value; 500,000 shares authorized; 31,207 shares issued and outstanding at June 30, 2017; 30,960 shares issued and outstanding at December 31, 2016	312	310
Additional paid in capital	366,917	361,682
Retained earnings	286,413	254,439
Accumulated other comprehensive loss	(116,696)	(158,530)
Total Kraton stockholders' equity	536,946	457,901
Noncontrolling interest	29,865	32,336
Total equity	566,811	490,237

Total liabilities and equity	\$3,062,526	\$2,906,645
------------------------------	-------------	-------------

See Notes to Condensed Consolidated Financial Statements

5

KRATON CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In thousands, except per share data)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2017	2016	2017	2016
Revenue	\$525,320	\$454,649	\$983,445	\$874,572
Cost of goods sold	378,064	322,752	692,823	648,857
Gross profit	147,256	131,897	290,622	225,715
Operating expenses:				
Research and development	9,759	10,114	20,104	20,690
Selling, general, and administrative	41,302	43,214	81,857	93,076
Depreciation and amortization	34,590	31,782	67,733	61,936
Operating income	61,605	46,787	120,928	50,013
Disposition and exit of business activities	—	(5,250)	—	40,001
Loss on extinguishment of debt	—	—	(19,738)	(13,423)
Earnings of unconsolidated joint venture	118	102	245	180
Interest expense, net	(34,444)	(33,742)	(68,749)	(67,580)
Income before income taxes	27,279	7,897	32,686	9,191
Income tax benefit (expense)	(3,854)	(1,029)	(5,072)	85,222
Consolidated net income	23,425	6,868	27,614	94,413
Net loss attributable to noncontrolling interest	2,136	533	4,360	1,075
Net income attributable to Kraton	\$25,561	\$7,401	\$31,974	\$95,488
Earnings per common share:				
Basic	\$0.82	\$0.24	\$1.03	\$3.10
Diluted	\$0.81	\$0.24	\$1.01	\$3.07
Weighted average common shares outstanding:				
Basic	30,585	30,158	30,508	30,095
Diluted	31,066	30,586	30,952	30,451

See Notes to Condensed Consolidated Financial Statements

6

KRATON CORPORATION
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
 (Unaudited)
 (In thousands)

	Three months ended June 30,		Six months ended June 30,	
	2017	2016	2017	2016
Net income attributable to Kraton	\$25,561	\$7,401	\$31,974	\$95,488
Other comprehensive income (loss):				
Foreign currency translation adjustments, net of tax of \$0	29,646	(2,250)	41,781	23,317
Unrealized gain (loss) on cash flow hedges, net of tax benefit of \$421, \$1,710, expense of \$30, and benefit of and \$2,710, respectively	(749)	(3,046)	94	(5,306)
Reclassification of gain on cash flow hedge	—	—	(41)	—
Other comprehensive income (loss), net of tax	28,897	(5,296)	41,834	18,011
Comprehensive income attributable to Kraton	54,458	2,105	73,808	113,499
Comprehensive loss attributable to noncontrolling interest	(2,133)	(742)	(2,471)	(538)
Consolidated comprehensive income	\$52,325	\$1,363	\$71,337	\$112,961

See Notes to Condensed Consolidated Financial Statements

7

KRATON CORPORATION
 CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN EQUITY
 (Unaudited)
 (In thousands)

	Common Stock	Additional Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total Kraton Stockholders' Equity	Noncontrolling Interest	Total Equity
Balance at December 31, 2015	\$ 306	\$349,871	\$147,131	\$ (138,568)	\$ 358,740	\$ 34,252	\$392,992
Net income (loss)	—	—	95,488	—	95,488	(1,075)	94,413
Other comprehensive income	—	—	—	18,011	18,011	537	18,548
Retired treasury stock from employee tax withholdings	(1)	(966)	—	—	(967)	—	