POLYONE CORP
Form 10-Q
October 30, 2007

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

þ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended September 30, 2007

o **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the transition period from __________ to __________.
Commission file number 1-16091

POLYONE CORPORATION
(Exact name of registrant as specified in its charter)

Ohio	**34-1730488**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*
33587 Walker Road, Avon Lake, Ohio	***44012***
(Address of principal executive offices)	*(Zip Code)*

Registrant s telephone number, including area code: **(440) 930-1000**
Former name, former address and former fiscal year, if changed since last report: **Not Applicable**

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 þ No o
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer o Accelerated filer þ Non-accelerated filer o
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes o No þ
The number of outstanding shares of the registrant s common stock, $0.01 par value, as of October 24, 2007 was 93,082,133

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Part I Financial Information
Item 1. Financial Statements

PolyOne Corporation and Subsidiaries
Condensed Consolidated Statements of Income (Unaudited)
(In millions, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2007	2006	2007	2006
Sales	$ 664.8	$ 666.2	$ 2,011.4	$ 2,027.2
Operating costs and expenses:				
Cost of sales	623.0	594.1	1,780.8	1,765.9
Selling and administrative	63.0	51.5	189.2	150.8
Depreciation and amortization	14.1	14.2	42.7	42.8
Income from equity affiliates and minority interest	11.7	30.0	16.6	100.3
Operating income (loss)	(23.6)	36.4	15.3	168.0
Interest expense	(11.9)	(16.2)	(43.2)	(49.6)
Interest income	1.6	1.1	3.4	2.4
Premium on early extinguishment of long-term debt	(7.5)		(12.8)	(1.2)
Other expense, net	(1.8)	(0.2)	(4.5)	(2.9)
Income (loss) before income taxes and discontinued operations	(43.2)	21.1	(41.8)	116.7
Income tax benefit (expense)	45.5	(1.5)	46.1	(5.6)
Income before discontinued operations	2.3	19.6	4.3	111.1
Loss from discontinued operations, net of income taxes				(2.1)
Net income	$ 2.3	$ 19.6	$ 4.3	$ 109.0
Earnings per common share:				
Basic and diluted earnings:				
Before discontinued operations	$ 0.02	$ 0.21	$ 0.05	$ 1.20
Discontinued operations				(0.02)
Basic and diluted earnings per share	$ 0.02	$ 0.21	$ 0.05	$ 1.18
Weighted average shares used to compute earnings per share:				
Basic	92.8	92.5	92.7	92.3
Diluted	93.3	93.0	93.1	92.7
Dividends declared per share of common stock	$	$	$	$

See Accompanying Notes to the Unaudited Condensed Consolidated Financial Statements

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PolyOne Corporation and Subsidiaries
Condensed Consolidated Balance Sheets (Unaudited)
(In millions)

	September 30, 2007	December 31, 2006
Assets		
Current assets:		
Cash and cash equivalents	$ 56.2	$ 66.2
Accounts receivable, net	382.4	316.4
Inventories	257.7	240.8
Deferred income tax assets	18.2	18.1
Other current assets	26.6	27.8
Total current assets	741.1	669.3
Property, net	451.2	442.4
Investment in equity affiliates	22.0	287.2
Goodwill	287.0	287.0
Other intangible assets, net	7.2	9.4
Deferred income tax assets	72.2	21.1
Other non-current assets	60.1	64.4
Total assets	$ 1,640.8	$ 1,780.8
Liabilities and Shareholders Equity		
Current liabilities:		
Short-term bank debt	$ 5.8	$ 5.2
Accounts payable	299.0	221.0
Accrued expenses	108.8	93.1
Current portion of long-term debt	22.2	22.5
Total current liabilities	435.8	341.8
Long-term debt	307.5	567.7
Post-retirement benefits other than pensions	83.0	83.6
Other non-current liabilities, including pensions	195.9	200.5
Minority interest in consolidated subsidiaries		5.5
Total liabilities	1,022.2	1,199.1
Shareholders equity	618.6	581.7
Total liabilities and shareholders equity	$ 1,640.8	$ 1,780.8

See Accompanying Notes to the Unaudited Condensed Consolidated Financial Statements.

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PolyOne Corporation and Subsidiaries
Condensed Consolidated Statements of Cash Flows (Unaudited)
(In millions)

	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006
Operating Activities		
Net income	$ 4.3	$ 109.0
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	42.7	42.8
Loss on disposition of discontinued business and plant phase-out charge		2.3
Charges for environmental remediation at inactive sites	31.9	1.8
Cash (payments) receipts for environmental remediation at inactive sites, net of insurance	(4.6)	2.7
Provision (benefit) for deferred income taxes	(52.2)	0.5
Premium on early extinguishment of long-term debt	12.8	1.2
Companies carried at equity and minority interest:		
Impairment of investment in equity affiliate	15.9	
Income from equity affiliates and minority interest	(32.5)	(100.3)
Dividends and distributions received	24.2	74.2
Change in assets and liabilities:		
Accounts receivable	(52.0)	(28.7)
Inventories	(9.0)	(36.4)
Accounts payable	68.7	30.6
Decrease in sale of accounts receivable		(7.9)
Accrued expenses and other	(5.6)	3.2
Net cash used by discontinued operations		(0.1)
Net cash provided by operating activities	44.6	94.9
Investing Activities		
Capital expenditures	(36.7)	(26.3)
Acquisition of minority interest in consolidated subsidiary	(11.0)	
Proceeds from sale of assets	4.0	7.2
Proceeds from sale of investment in equity affiliate	260.5	
Proceeds from sale of discontinued business, net		17.3
Net cash used by discontinued operations		(0.2)
Net cash provided (used) by investing activities	216.8	(2.0)
Financing Activities		
Change in short-term debt	(0.2)	(3.0)
Repayment of long-term debt	(263.4)	(15.7)
Premium on early extinguishment of long-term debt	(12.8)	(1.2)
Proceeds from exercise of stock options	0.9	2.8
Net cash used by financing activities	(275.5)	(17.1)

Effect of exchange rate changes on cash	4.1	0.7
Increase (decrease) in cash and cash equivalents	(10.0)	76.5
Cash and cash equivalents at beginning of period	66.2	32.8
Cash and cash equivalents at end of period	$ 56.2	$ 109.3

See Accompanying Notes to the Unaudited Condensed Consolidated Financial Statements.

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PolyOne Corporation and Subsidiaries
Condensed Consolidated Statements of Shareholders Equity (Unaudited)
(Dollars in millions, shares in thousands)

	Common Shares Outstanding	Common Shares Held in Treasury	Total	Common Stock	Additional Paid-In Capital	Retained Earnings (Deficit)	Common Stock Held In Treasury	Accumulated Other Comprehensive Income (Loss)
Balance January 1, 2006	122,192	30,255	$ 387.4	$ 1.2	$ 1,066.4	$ (190.3)	$ (337.1)	$ (152.8)
Cumulative effect of adoption of FSP AUG AIR-1 as of January 1, 2006			7.0			7.0		
Comprehensive income:								
Net income			46.9			46.9		
Translation adjustment			0.9					0.9
Total comprehensive income			47.8					
Stock-based compensation and benefits		(550)	3.1		(0.2)		4.0	(0.7)
Balance March 31, 2006	122,192	29,705	$ 445.3	$ 1.2	$ 1,066.2	$ (136.4)	$ (333.1)	$ (152.6)
Comprehensive income:								
Net income			42.5			42.5		
Translation adjustment			5.2					5.2
Total comprehensive income			47.7					
Stock-based compensation and benefits		(163)	1.2		(0.3)		1.5	
Balance June 30, 2006	122,192	29,542	$ 494.2	$ 1.2	$ 1,065.9	$ (93.9)	$ (331.6)	$ (147.4)

Comprehensive income:								
Net income			19.6			19.6		
Translation adjustment			3.9					3.9
Total comprehensive income			23.5					
Stock-based compensation and benefits		(41)	2.6		(1.5)		4.1	
Balance September 30, 2006	122,192	29,501	$ 520.3	$ 1.2	$ 1,064.4	$ (74.3)	$ (327.5)	$ (143.5)
Balance January 1, 2007	122,192	29,384	$ 581.7	$ 1.2	$ 1,065.7	$ (59.9)	$ (326.2)	$ (99.1)
Comprehensive income:								
Net income			7.4			7.4		
Amortization of unrecognized losses, transition obligation and prior service costs, net of tax of $0.5			1.0					1.0
Translation adjustment			3.0					3.0
Total comprehensive income			11.4					
Stock-based compensation and benefits		(70)	0.5		(0.3)		0.8	
Balance March 31, 2007	122,192	29,314	$ 593.6	$ 1.2	$ 1,065.4	$ (52.5)	$ (325.4)	$ (95.1)
Comprehensive income:								
Net loss			(5.4)			(5.4)		
Amortization of unrecognized losses, transition obligation and prior			1.0					1.0

service costs, net of tax of $0.5								
Translation adjustment			9.0					9.0
Total comprehensive income			4.6					
Stock-based compensation and benefits		(113)	3.2		1.9		1.3	
Balance June 30, 2007	122,192	29,201	$ 601.4	$ 1.2	$ 1,067.3	$ (57.9)	$ (324.1)	$ (85.1)
Comprehensive income:								
Net income			2.3			2.3		
Amortization of unrecognized losses, transition obligation and prior service costs, net of tax of $0.4			3.6					3.6
Translation adjustment			10.0					10.0
Total comprehensive income			15.9					
Stock-based compensation and benefits		(66)	1.3		0.6		0.7	
Balance September 30, 2007	122,192	29,135	$ 618.6	$ 1.2	$ 1,067.9	$ (55.6)	$ (323.4)	$ (71.5)

See Accompanying Notes to the Unaudited Condensed Consolidated Financial Statements.

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PolyOne Corporation and Subsidiaries
INDEX TO NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note A Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with Form 10-Q instructions and in the opinion of management contain all adjustments, consisting of normal recurring accruals, necessary to present fairly the financial position, results of operations and cash flows for the periods presented. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates. These interim financial statements should be read in conjunction with the financial statements and accompanying notes included in the Annual Report on Form 10-K for the year ended December 31, 2006 of PolyOne Corporation.

As of January 1, 2007, PolyOne s vinyl operations located in Singapore have been managed and reported under the Vinyl Business operating segment. Historically, the results of this operation were included in the International Color and Engineered Materials operating segment. Prior period results of operations have been reclassified to conform to the 2007 presentation.

Operating results for the three-month and nine-month periods ended September 30, 2007 are not necessarily indicative of the results that may be attained in subsequent periods or for the year ending December 31, 2007. Unless otherwise noted, disclosures contained in this quarterly report relate to continuing operations.

Reclassification Certain amounts for 2006 have been reclassified to conform to the 2007 presentation.

Note B Discontinued Operations

The Engineered Films business was sold in February 2006. As a result, PolyOne no longer has any businesses that are accounted for as discontinued operations. The 2006 loss included a pre-tax charge of $2.3 million to adjust the net assets of the Engineered Films business to the net proceeds received from the sale of the business and to recognize costs that were not able to be recognized until the Engineered Films business was sold due to the contingent nature of these costs, as required by U.S. generally accepted accounting principles.

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Note C Accounting Policies

Deferred Taxes A valuation allowance was initially recorded against domestic deferred tax assets in the fourth quarter of 2003 as a result of operating losses. The valuation allowance was adjusted in subsequent periods through 2006 and charged or credited to income or other comprehensive income as appropriate. In the fourth quarter of 2006, it was determined that it was more likely than not that the deferred tax assets would be realized and the remaining amount of valuation allowance was reversed to income in that period. Therefore, beginning with the first quarter of 2007, a tax (benefit) expense has been recorded based on an estimated effective tax rate for all jurisdictions.

New Accounting Pronouncements

SFAS No. 158 On December 31, 2006, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 158, Employer s Accounting for Defined Benefit Pension and Other Postretirement Plans an Amendment of FASB Statements No. 87, 88, 106 and 132(R). SFAS No. 158 requires an employer that is a business entity and sponsors one or more single employer benefit plans to (1) recognize the funded status of the benefit in its statement of financial position, (2) recognize as a component of other comprehensive income, net of tax, the gains or losses and prior service costs or credits that arise during the period but are not recognized as components of net periodic benefit cost, (3) measure defined benefit plan assets and obligations as of the date of the employer s fiscal year end statement of financial position and (4) disclose additional information in the notes to financial statements about certain effects on net periodic benefit costs for the next fiscal year that arise from delayed recognition of gains or losses, prior service costs or credits, and transition assets or obligations.

The adoption of SFAS No. 158 resulted in an increase of $6.4 million on a pre-tax basis and a $0.4 million decrease on an after-tax basis on the Company s accumulated other comprehensive loss. PolyOne also recorded an adjustment of $2.7 million to increase accumulated other comprehensive loss to record its proportionate share of the adoption of SFAS No. 158 by Oxy Vinyls, LP (OxyVinyls). In July 2007, the Company sold its 24% interest in OxyVinyls. See Note G Investments in Equity Affiliates for further information.

The adoption of SFAS No. 158 had no effect on the Company s compliance with the financial covenants contained in the agreements governing its debt and its receivables sales facility, and is not expected to affect the Company s operating results in future periods.

SFAS No. 157 In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157, Fair Value Measurement, which defines fair value, establishes the framework for measuring fair value under U.S. generally accepted accounting principles and expands disclosures about fair value measurements. We will adopt SFAS No. 157 as of January 1, 2008, and we are evaluating the effect, if any, that adoption will have on our financial statements in 2008.

FASB Interpretation No. 48 In June 2006, the FASB issued Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109, Accounting for Income Taxes, which is effective for fiscal years beginning after December 15, 2006. FIN 48 clarifies the recognition threshold and measurement attributes for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognizing, classification, interest and penalties, accounting in interim periods, disclosure and transition. PolyOne adopted FIN 48 effective January 1, 2007. The adoption of FIN 48 did not have a material impact on the Company s financial position or results of operations. PolyOne has a $6.4 million liability for uncertain tax positions. This amount relates to items under examination by foreign tax authorities related to the valuation of assets. PolyOne does not agree with the proposed adjustments and has appealed the assessments. PolyOne does not anticipate that the disputes will be resolved in the next twelve months.

PolyOne will continue the accounting policy to classify interest and penalties on uncertain tax positions as income taxes. As of September 30, 2007, PolyOne has accrued $3.1 million of interest and penalties. PolyOne is no longer subject to U.S. income tax examinations for periods preceding 2004, and with limited exceptions, for periods preceding 2002 for foreign, state and local tax examinations.

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FASB Staff Position AUG AIR-1 In September 2006, the FASB issued FASB Staff Position (FSP) AUG AIR-1, Accounting for Planned Major Maintenance Activities (FSP AUG AIR-1). FSP AUG AIR-1 prohibits the use of the accrue-in-advance method of accounting for planned major maintenance activities in annual and interim financial reporting periods and is effective for the first fiscal year beginning after December 15, 2006. OxyVinyls adopted FSP AUG AIR-1 in the first quarter of 2007, on a retrospective basis, and is now using the deferral method of accounting for planned major maintenance. The effect on OxyVinyls consolidated balance sheet at January 1, 2007 from adopting FSP AUG AIR-1 was an increase of $38.3 million in other assets, a decrease of $12.3 million in accrued liabilities, an increase of $4.2 million in minority interest and an increase of $46.4 million in partners capital. PolyOne s proportionate share of its former equity investment in OxyVinyls operations was 24%. See Note G Investments in Equity Affiliates for further information regarding the Company s interest in OxyVinyls.

The adoption of FSP AUG AIR-1 represents a change in accounting principle and, under the guidance of this principle, must be applied retrospectively. Under these retrospective provisions, PolyOne has restated its historical financial statements to reflect the change in accounting for planned major maintenance activities of its former equity affiliate. The following tables illustrate the retrospective changes in PolyOne s financial statements:

Condensed Consolidated Statements of Income (Unaudited)

(In millions)

	Nine Months Ended September 30, 2006		
	As originally filed	**Adjustment**	**Restated**
Income from equity affiliates and minority interest	$100.1	$ 0.2	$100.3
Income before discontinued operations	110.9	0.2	111.1
Net income	108.8	0.2	109.0

Condensed Consolidated Balance Sheets (Unaudited)

(In millions)

	December 31, 2006		
	As originally filed	**Adjustment**	**Restated**
Investment in equity affiliates	$ 276.1	$ 11.1	$ 287.2
Deferred income tax assets	25.0	(3.9)	21.1
Total assets	1,773.6	7.2	1,780.8
Retained deficit	(67.1)	7.2	(59.9)
Shareholders equity	574.5	7.2	581.7

The cumulative effect of the adoption of FSP AUG AIR-1 as of January 1, 2006 is a reduction to retained deficit and an increase to shareholders equity of $7.0 million.

Condensed Consolidated Statements of Cash Flows (Unaudited)

(In millions)

	Nine Months Ended September 30, 2006		
	As originally filed	**Adjustment**	**Restated**
Net income	$ 108.8	$ 0.2	$ 109.0
Income from equity affiliates and minority interest	(100.1)	(0.2)	(100.3)

Use of Estimates The preparation of Consolidated Financial Statements in conformity with U.S. generally accepted accounting principles requires management to make extensive use of estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the Consolidated

Financial Statements and the reported amounts of revenues and expenses during these periods. Significant estimates in these Consolidated Financial Statements include, but are not limited to, sales discounts and rebates, allowances for doubtful accounts, estimates of future cash flows associated with assets, asset impairments, useful lives for depreciation and amortization, loss contingencies, net realizable value of inventories, environmental-related liabilities, income taxes and tax valuation reserves, assumptions used for goodwill impairment analyses and the determination of discount and other rate assumptions used to determine pension and post-retirement employee benefit expenses. Actual results could differ from these estimates.

Note D Goodwill and Intangible Assets

Goodwill as of September 30, 2007 and December 31, 2006, by operating segment, was as follows:

(In millions)	September 30, 2007	December 31, 2006
Vinyl Business	$ 152.3	$ 152.3
International Color and Engineered Materials	72.0	72.0
Polymer Coating Systems	61.1	61.1
PolyOne Distribution	1.6	1.6
Total	$ 287.0	$ 287.0

SFAS No. 142, Goodwill and Other Intangible Assets, requires an annual assessment for potential impairment of goodwill. PolyOne has selected July 1 as its annual assessment date. During the third quarter of 2007, the goodwill impairment assessment was completed and it was determined that goodwill was not impaired as of July 1, 2007. The combination of two valuation methodologies, a market approach and an income approach, was used to estimate the fair value of PolyOne s reporting units that supported significant goodwill, specifically Vinyl Compounds, International Color and Engineered Materials, and Polymer Coating Systems. The market approach estimates fair value by applying sales, earnings and cash flow multiples (derived from comparable publicly-traded companies with similar investment characteristics of the reporting unit) to the reporting unit s operating performance adjusted for non-recurring items. The income approach is based on projected future debt-free cash flow that is discounted to present value using discount factors that consider the timing and risk associated with the respective reporting units. As a result of the July 1, 2007 impairment testing, the average fair values of the market approach and income approach exceeded the carrying value by 52%, 8% and 24% for the Vinyl Compounds, International Color and Engineered Materials, and Polymer Coating Systems reporting units, respectively.

While PolyOne determined that there was no goodwill impairment as of the July 1, 2007 annual assessment, the occurrence of a potential indicator of impairment in the future, such as a significant adverse change in legal factors or business climate, an adverse action or assessment by a regulator, unanticipated competition, loss of key personnel or a more-likely-than-not expectation that a reporting unit or a significant portion of a reporting unit will be sold or disposed of, would result in having to perform an interim assessment for some or all of the reporting units prior to the next required annual assessment on July 1, 2008.

Information regarding PolyOne s other intangible assets follows:

	As of September 30, 2007			
(In millions)	Acquisition Cost	Accumulated Amortization	Currency Translation	Net
Non-contractual customer relationships	$ 8.6	$ (6.5)	$	$ 2.1
Sales contract	11.4	(9.7)		1.7
Patents, technology and other	4.7	(2.6)	1.3	3.4
Total	$ 24.7	$ (18.8)	$ 1.3	$ 7.2

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	As of December 31, 2006			
(In millions)	Acquisition Cost	Accumulated Amortization	Currency Translation	Net
Non-contractual customer relationships	$ 8.6	$ (6.1)	$	$ 2.5
Sales contract	9.6	(9.1)		0.5
Patents, technology and other	8.0	(2.9)	1.3	6.4
Total	$ 26.2	$ (18.1)	$ 1.3	$ 9.4

Amortization of other intangible assets was $0.1 million and $0.5 million for the three-month periods ended September 30, 2007 and 2006, respectively, and $1.6 million and $1.5 million for the nine-month periods ended September 30, 2007 and 2006, respectively.

The carrying values of intangible assets and other investments are adjusted to the estimated net future cash flows based upon an evaluation done each year end, or more often, when indicators of impairment exist. For the nine-month period ended September 30, 2007, an impairment charge of $2.5 million was recorded against the carrying value of certain patents and technology agreements.

Note E Inventories

Components of inventories are as follows:

(In millions)	September 30, 2007	December 31, 2006
Finished products and in-process inventories	$ 193.3	$ 165.4
Raw materials and supplies	107.2	111.7
	300.5	277.1
LIFO reserve	(42.8)	(36.3)
Total	$ 257.7	$ 240.8

Note F Income Tax

A deferred tax asset valuation allowance was recorded in 2003 in accordance with SFAS No. 109, Accounting for Income Taxes, due to the uncertainty regarding the full realization of the Company s deferred income taxes. In 2005 and 2006, a portion of the valuation allowance was reversed, reducing income tax expense in those periods. In the fourth quarter of 2006, the Company determined that it was more likely than not that the remaining deferred tax asset would be realized and the remaining valuation allowance was reversed and reduced income tax expense in that period. As a result, income taxes in the third quarter of 2007 and first nine months of 2007 were recorded without regard to any domestic deferred tax valuation allowance. Excluding a $31.5 million tax benefit resulting from the reversal of deferred tax liabilities recognized upon the sale of the Company s 24% interest in OxyVinyls, the third quarter of 2007 tax benefit of $14.0 million reflects an effective tax rate of 32.4% and the tax benefit of $14.6 million in the first nine months of 2007 reflects an effective tax rate of 34.9%. The difference between the effective rate and the statutory rate was primarily due to the impact of foreign source income and domestic losses.

The tax expense of $1.5 million in the third quarter of 2006 and $5.6 million in the first nine months of 2006 was net of the reversal of a portion of the valuation allowance. The income tax expense in each period represents federal alternative minimum taxes, state and local taxes and foreign taxes.

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Note G Investment in Equity Affiliates

SunBelt Chlor-Alkali Partnership (SunBelt) is the most significant of PolyOne s equity investments and is reported within the Resin and Intermediates segment. PolyOne owns 50% of SunBelt. On July 6, 2007, PolyOne sold its 24% interest in OxyVinyls, a manufacturer and marketer of PVC resins, for cash proceeds of $260.5 million. No equity affiliate earnings of OxyVinyls were recorded by PolyOne for the three months ended September 30, 2007.

The following table presents OxyVinyls summarized financial results for the periods indicated:

(Dollars in millions)	Three Months Ended September 30, 2006	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006
Net sales	$ 659.2	$ 1,108.3	$ 1,999.5
Operating income	71.9	10.9	241.7
Partnership income as reported by OxyVinyls	$ 65.4	$ 2.7	$ 235.4
PolyOne s ownership of OxyVinyls	24%	24%	24%
PolyOne s proportionate share of OxyVinyls earnings	15.7	0.6	56.5
Amortization of the difference between PolyOne s investment and its underlying share of OxyVinyls equity	0.1	0.3	0.4
Equity affiliate earnings recorded by PolyOne	$ 15.8	$ 0.9	$ 56.9

(In millions)	December 31, 2006
Current assets	$ 382.4
Non-current assets	1,293.2
Total assets	1,675.6
Current liabilities	238.9
Non-current liabilities	294.5
Total liabilities	533.4
Partnership capital	$ 1,142.2

The following table presents SunBelt s summarized financial results for the periods indicated:

(Dollars in millions)	Three Months Ended September 30, 2007	Three Months Ended September 30, 2006	Nine Months Ended September 30, 2007	Nine Months Ended September 30, 2006
Net sales	$ 51.9	$ 49.9	$ 136.1	$ 145.6
Operating income	27.4	28.1	67.8	85.5

Partnership income as reported by SunBelt	$ 25.1	$ 25.7	$ 61.1	$ 78.2
PolyOne s ownership of SunBelt	50%	50%	50%	50%
Equity affiliate earnings recorded by PolyOne	$ 12.6	$ 12.8	$ 30.6	$ 39.1

(In millions)	September 30, 2007	December 31, 2006
Current assets	$ 47.2	$ 25.1
Non-current assets	108.8	113.7
Total assets	156.0	138.8
Current liabilities	23.1	22.1
Non-current liabilities	121.9	121.9
Total liabilities	145.0	144.0
Partnership capital (deficit)	$ 11.0	$ (5.2)

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Other investments in equity affiliates are discussed below:
The BayOne Urethane Systems, L.L.C. equity affiliate (owned 50%) is included in the Polymer Coating Systems operating segment. The Vinyl Business operating segment includes the Geon/Polimeros Andinos equity affiliate (owned 50%). Combined summarized financial information for these equity affiliates is presented below. The amounts shown represent the entire operations of these businesses.

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
(In millions)	**2007**	**2006**	**2007**	**2006**
Net sales	$34.7	$22.9	$88.0	$74.5
Operating income	2.4	2.0	6.2	6.6
Net income	1.6	1.7	5.3	5.6

These results exclude PolyOne s share of the write-down of certain assets by Geon/Polimeros Andinos. PolyOne s proportionate share was a charge to income from equity affiliates and minority interest of $1.6 million in the third quarter 2007.
Prior to its acquisition, DH Compounding Company (DHC) was accounted for as an equity affiliate (owned 50% and included in the Producer Services operating segment). On October 1, 2006, PolyOne purchased the remaining 50% interest in DHC from a subsidiary of The Dow Chemical Company. DHC is now fully consolidated in the financial statements of PolyOne, and is therefore excluded from the information provided above.

Note H Share-Based Compensation

Share-based compensation expense recognized during a period is based on the value of the portion of share-based payment awards that is ultimately expected to vest during the period. Share-based compensation expense recognized in the Company s Condensed Consolidated Statement of Income includes compensation expense for share-based payment awards granted on or subsequent to January 1, 2006 based on the grant date fair value estimated in accordance with the provision of SFAS No. 123(R), Share-Based Payments. Because share-based compensation expense recognized in the Condensed Consolidated Statement of Income is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS No. 123(R) requires that forfeitures be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates.
PolyOne has one active share-based compensation plan, which is described below. The cost is included in selling and administrative expenses on the Condensed Consolidated Statement of Income. The pre-tax compensation cost recognized for the three months ended September 30, 2007 and 2006 was $1.0 million and $2.0 million, respectively. The pre-tax compensation expense recognized for the nine months ended September 30, 2007 and 2006 was $3.6 million and $4.2 million, respectively.

2005 Equity and Performance Incentive Plan

In May 2005, PolyOne s shareholders approved the PolyOne Corporation 2005 Equity and Performance Incentive Plan (2005 EPIP). All future grants and awards to PolyOne employees will be issued only from this plan until there are no shares remaining under the plan or until the shareholders approve a new equity plan. All previous equity-based plans were frozen upon the approval of the 2005 EPIP in May 2005. The 2005 EPIP provides for the award of a broad variety of share-based compensation alternatives, including non-qualified stock options, incentive stock options, restricted stock, restricted stock units, performance shares, performance units and stock appreciation rights. A total of five million shares of common stock have been reserved for grants and awards under the 2005 EPIP. It is anticipated that all share-based grants and awards that are earned and exercised will be issued from shares of PolyOne common stock that are held in treasury.

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Stock Appreciation Rights

During the first quarter of 2007, the Compensation and Governance Committee of the Company s Board of Directors authorized the issuance of 1,555,200 stock appreciation rights (SARs). Vesting is based on a service period of one year and the achievement of stock price targets. This condition is considered a market-based measure under SFAS No. 123(R), which is considered in determining the grant s fair value. This fair value is not subsequently revised for actual market price achievement, but rather is a fixed expense subject only to service-related forfeitures. The awards vest in one-third increments based on stock price achievement (for a minimum of three consecutive trading days) of $7.24, $7.90 and $8.56, but may not be exercised earlier than one year from the date of the grant. At September 30, 2007, these awards have reached the $8.56 stock price achievement target. The SARs have a seven-year exercise period that expires on March 7, 2014.

PolyOne utilizes an option pricing model based on the Monte Carlo simulation method that values SAR awards. Under this method, the fair value of awards on the date of grant is an estimate and is affected by the Company s stock price, as well as assumptions regarding a number of highly complex and subjective variables as noted in the following table. Expected volatility was set at the average of the six-year historical weekly volatility for PolyOne and the implied volatility rates for exchange traded options. The expected term of options granted was set equal to the midpoint between the vesting and expiration dates for each grant. Dividends were omitted in this calculation because PolyOne does not currently pay dividends. The risk-free rate of return for periods within the contractual life of the option is based on U.S. Treasury rates in effect at the time of the grant. Forfeitures were estimated at 3% per year and were based on PolyOne s historical experience.

The following is a summary of the assumptions related to the grants issued during 2007:

	2007
Expected volatility	44.00%
Expected dividends	
Expected term	4.28 years
Risk-free rate	4.30%
Value of SAR options granted	$2.72

A summary of SAR option activity as of September 30, 2007 and changes during the nine months then ended are presented below:

(Shares in thousands, dollars in millions, except per share data) **Stock Appreciation Rights**	**Shares**	**Weighted-Average Exercise Price Per Share**	**Weighted-Average Remaining Contractual Term**	**Aggregate Intrinsic Value**
Outstanding at January 1, 2007	1,640	$ 7.90		
Granted	1,617	6.63		
Exercised	(57)	6.50		
Forfeited or expired	(199)	7.14		
Outstanding at September 30, 2007	3,001	$ 7.30	5.7 years	$ 1.9
Vested and exercisable at September 30, 2007	899	$ 7.96	4.9 years	$ 0.4

The weighted-average grant date fair value of SARs granted during the nine months ended September 30, 2007 and 2006 was $2.74 and $2.98, respectively. The total intrinsic value of SARs that were exercised during the nine months ended September 30, 2007 and 2006 was $0.1 million and $1.3 million, respectively.

As of September 30, 2007, there was $1.7 million of total unrecognized compensation cost related to SARs, which is expected to be recognized within a period of twelve months.

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Stock Options

PolyOne s incentive stock plans previously provided for the award or grant of options to purchase PolyOne common stock. Options granted generally become exercisable at the rate of 35% after one year, 70% after two years and 100% after three years. The term of each option cannot extend beyond 10 years from the date of grant. All options are granted at 100% or greater of market value (as defined) on the date of the grant.

A summary of option activity as of September 30, 2007 and changes during the nine months then ended follow:

(Shares in thousands, dollars in millions, except per share data)

Options	**Shares**	**Weighted-Average Exercise Price**	**Weighted-Average Remaining Contractual Term**	**Aggregate Intrinsic Value**
Outstanding at January 1, 2007	7,385	$ 11.47		
Granted				
Exercised	(144)	6.00		
Forfeited or expired	(758)	12.44		
Outstanding, vested and exercisable at September 30, 2007	6,483	$ 11.48	2.28 Years	$ 0.8

The total intrinsic value of stock options that were exercised during the nine months ended September 30, 2007 and 2006 was $0.1 million and $0.8 million, respectively.

Cash received during the first nine months of 2007 and 2006 from the exercise of stock options was $0.9 million and $2.8 million, respectively.

Performance Shares

At September 30, 2007, there were 490,700 performance share awards outstanding with a weighted-average fair value of $8.94 per share. As a result of adjustments to performance forecasts and forfeitures, no net compensation expense was recognized on these awards for the nine months ended September 30, 2007. For the nine months ended September 30, 2006, $1.7 million was recognized. As of September 30, 2007, based on projected performance attainment for the remaining life of the awards, the unrecognized compensation cost of these awards is approximately $0.5 million.

Restricted Stock Awards

As of September 30, 2007, 235,600 shares of restricted stock remain unvested with a weighted-average grant date fair value of $8.70 and a weighted-average remaining contractual term of 20 months. Compensation expense recorded during the nine months ended September 30, 2007 and 2006 was $0.5 million and $0.4 million, respectively. Unrecognized compensation cost for restricted stock awards at September 30, 2007 was $1.1 million.

Note I Earnings Per Share Computation

	Three Months Ended September 30,		**Nine Months Ended September 30,**	
(In millions)	**2007**	**2006**	**2007**	**2006**
Weighted-average shares outstanding basic	92.8	92.5	92.7	92.3
Weighted-average shares diluted:				
Weighted-average shares outstanding basic	92.8	92.5	92.7	92.3

Plus dilutive impact of stock options and stock awards	0.5	0.5	0.4	0.4
Weighted-average shares diluted	93.3	93.0	93.1	92.7

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Basic earnings per common share is computed as net income available to common shareholders divided by weighted-average basic shares outstanding. Diluted earnings per common share is computed as net income available to common shareholders divided by weighted-average diluted shares outstanding.

Outstanding SARs and stock options with exercise prices greater than the average price of the common shares are anti-dilutive and are not included in the computation of diluted earnings per share. The number of anti-dilutive options and awards was 6.8 million at September 30, 2007 and 7.8 million at September 30, 2006.

Note J Employee Separation and Plant Phaseout

Since the formation of PolyOne in 2000, management has undertaken several restructuring initiatives to improve profitability and, as a result, PolyOne has incurred employee separation and plant phaseout costs. For further discussion of these initiatives, see Note E to the Consolidated Financial Statements included in PolyOne s Annual Report on Form 10-K for the year ended December 31, 2006.

For the nine-month period ended September 30, 2007, $2.2 million of charges were recorded, of which $0.8 million was included in Selling and administrative expense and $1.4 million was included in Cost of sales on the Condensed Consolidated Statement of Income. For the same period in 2006, benefits of $0.4 million and $0.2 million were recorded in Cost of sales and Selling and administrative in the Condensed Consolidated Statement of Income, respectively. Cash spending during the three-month and nine-month periods ended September 30, 2007 was $0.4 million and $1.2 million, respectively.

2007 Activity- During the nine-month period ended September 30, 2007, the Company recognized and paid $0.4 million in employee separation charges related to 33 employees involved in the restructuring of its manufacturing facility in St. Peters, Missouri, part of the North American Color and Additives operating segment.

The closure and exit from the Company s Commerce, California facility was completed in the first quarter of 2007, during which the Company paid $0.1 million in employee separation charges and $0.1 million in plant phase-out costs.

During the nine months ended September 30, 2007, charges related to three executive severance agreements in the amount of $0.6 million were recognized. Accrued executive severance costs at September 30, 2007 are $1.3 million and are expected to be paid over 24 months.

In September 2007, PolyOne announced the closure of two manufacturing lines at its Avon Lake, Ohio facility. Non-cash charges of $0.5 million were recorded to adjust the carrying value of certain assets to their net realizable value. In addition, during the third quarter of 2007, severance costs of $0.4 million for seven employees at the Avon Lake and other facilities were recorded.

PolyOne s liability for unpaid severance cost was $1.7 million at September 30, 2007.

In addition, during the first nine months of 2007, $0.3 million of other non-cash charges were incurred as the Company adjusted previous carrying values of assets held for sale.

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Note K Employee Benefit Plans

Components of defined benefit pension plan costs are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In millions)	2007	2006	2007	2006
Service cost	$ 0.2	$ 0.3	$ 0.8	$ 1.0
Interest cost	7.3	7.5	22.5	22.4
Expected return on plan assets	(7.8)	(7.6)	(23.8)	(22.7)
Amortization of unrecognized losses, transition obligation and prior service cost	2.1	3.7	7.3	11.0
	$ 1.8	$ 3.9	$ 6.8	$ 11.7

During the nine months ended September 30, 2007, contributions of $14.9 million were made.

Components of post-retirement health care plan benefit costs are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
(In millions)	2007	2006	2007	2006
Service cost	$ 0.1	$ 0.1	$ 0.3	$ 0.3
Interest cost	1.1	1.4	3.9	4.2
Expected return on plan assets				
Amortization of unrecognized losses, transition obligation and prior service cost	(0.9)	(0.9)	(3.1)	(2.7)
	$ 0.3	$ 0.6	$ 1.1	$ 1.8

Note L Financing Arrangements

Long-term Debt At September 30, 2007, PolyOne had long-term debt of $329.7 million, with maturities through 2015. Current maturities of long-term debt at September 30, 2007 and December 31, 2006 were $22.2 million and $22.5 million, respectively. PolyOne repurchased $100.0 million of its 10.625% senior notes in June 2007 and repurchased the remaining $141.4 million of such senior notes in August 2007. PolyOne had previously repurchased $15.0 million of such senior notes in June 2006. All of these repurchases were at a premium. For the first nine months of 2007 and 2006, the premiums paid were $12.8 million and $1.2 million, respectively, and are shown as a separate line item in the Condensed Consolidated Statements of Income. In addition, for the nine month periods ended September 30, 2007 and 2006, unamortized deferred note issuance costs of $2.8 million and $0.2 million, respectively, were expensed due to the debt repurchase and are included in interest expense in the Condensed Consolidated Statements of Income.

PolyOne is exposed to market risk from changes in interest rates on debt obligations and from changes in foreign currency exchange rates. Information about these risks and exposure management is included in Item 7A Qualitative and Quantitative Information about Market Risk in PolyOne s Annual Report on Form 10-K for the year ended December 31, 2006. PolyOne periodically enters into interest rate swap agreements that modify its exposure to interest rate risk by converting fixed-rate obligations to floating rates. PolyOne maintained interest rate swap agreements on five of its fixed-rate obligations in the aggregate amount of $80.0 million at September 30, 2007. At September 30, 2007, these agreements had a net fair value obligation of $3.0 million. The weighted-average interest rate for these five agreements was 9.0%. There have been no material changes in the market risk faced by PolyOne from December 31, 2006 to September 30, 2007.

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Note M Sale of Accounts Receivable

Accounts receivable consist of the following:

(In millions)	September 30, 2007	December 31, 2006
Trade accounts receivable	$ 181.8	$ 160.7
Retained interest in securitized accounts receivable	205.6	161.6
Allowance for doubtful accounts	(5.0)	(5.9)
	$ 382.4	$ 316.4

Under the terms of its receivables sale facility, PolyOne sells its accounts receivable to PolyOne Funding Corporation (PFC), a wholly owned, fully consolidated, bankruptcy-remote subsidiary. PFC in turn may sell an undivided interest in these accounts receivable to certain investors. This facility size is $200.0 million. As of September 30, 2007, $155.4 million was available. The receivables sale facility was amended in June 2007 to extend the maturity of the facility to June 2012 and to, among other things, modify certain financial covenants and reduce the cost of utilizing the facility. In July 2007, the Company entered into a Canadian receivables purchase agreement, which increased the facility size by $25.0 million to $200.0 million.

At September 30, 2007 and December 31, 2006, accounts receivable totaling $205.6 million and $161.6 million, respectively, were sold by PolyOne to PFC. The maximum amount of proceeds that PFC may receive under the facility is limited to 85% of the eligible accounts receivable that are sold to PFC. At September 30, 2007 and December 31, 2006, PFC had sold none of its undivided interest in accounts receivable.

PolyOne retained an interest in the difference between the amount of trade receivables sold by PolyOne to PFC and the undivided interest sold by PFC as of September 30, 2007 and December 31, 2006. As a result, the interest retained by PolyOne of $205.6 million and $161.6 million is included in accounts receivable on the Condensed Consolidated Balance Sheet at September 30, 2007 and December 31, 2006, respectively.

The receivables sale facility also makes up to $40.0 million available for the issuance of standby letters of credit as a sub-limit within the $200.0 million facility, of which $10.9 million was used at September 30, 2007. Continued availability of the receivables sale facility depends upon compliance with a fixed charge coverage ratio covenant related primarily to operating performance that is set forth in the related agreements. As of September 30, 2007, PolyOne was in compliance with this covenant.

Note N Segment Information

PolyOne manages its business in eight operating segments, of which four are reportable segments: Vinyl Business, International Color and Engineered Materials, PolyOne Distribution, and Resin and Intermediates. The All Other category includes four operating segments, none of which meets the quantitative thresholds for separate disclosure: North American Color and Additives, North American Engineered Materials, Producer Services and Polymer Coating Systems.

As of January 1, 2007, PolyOne s vinyl operations located in Singapore are managed and reported within the Vinyl Business operating segment. Historically, the results of this operation were included in the International Color and Engineered Materials operating segment. Prior period results of operations have been reclassified to conform to the 2007 presentation.

The accounting policies of each segment are consistent with those described in Summary of Significant Accounting Policies in Note C to the Consolidated Financial Statements included in PolyOne s Annual Report on Form 10-K for the year ended December 31, 2006.

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Operating income is the primary measure that is reported to the chief operating decision maker for purposes of making decisions about allocating resources to the segment and assessing its performance. The measure of segment operating income or loss that is reported to and reviewed by the chief operating decision maker excludes significant costs that are not controllable by or the responsibility of segment management. These costs are included in Corporate and eliminations and consist of: 1) inter-segment sales and profit eliminations; 2) charges related to specific strategic initiatives such as the consolidation of operations; 3) significant restructuring activities, including employee separation costs resulting from personnel reduction programs, plant closure and phaseout costs; 4) executive separation agreements; 5) share-based compensation costs; 6) asset impairments; 7) environmental remediation costs for facilities no longer owned or closed in prior years; 8) gains and losses on the divestiture of joint ventures and equity investments; and 9) certain other items.

Segment assets have not changed significantly from the amount reported in Note R to the Consolidated Financial