

POLYONE CORP  
Form 10-Q  
November 05, 2008

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

**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the quarterly period ended September 30, 2008**

**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**

*(State or other jurisdiction  
of incorporation or organization)*

**34-1730488**

*(I.R.S. Employer Identification No.)*

**33587 Walker Road, Avon Lake, Ohio**

*(Address of principal executive offices)*

**44012**

*(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  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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting  
company

(Do not check if a smaller  
reporting company)

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

The number of outstanding shares of the registrant's common stock, \$0.01 par value, as of November 3, 2008 was 92,524,404.

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

|   | <b>Three Months Ended</b> |             | <b>Nine Months Ended</b> |             |
|---|---------------------------|-------------|--------------------------|-------------|
|   | <b>September 30,</b>      |             | <b>September 30,</b>     |             |
|   | <b>2008</b>               | <b>2007</b> | <b>2008</b>              | <b>2007</b> |
| Sales   | \$ 735.1                  | \$ 664.8    | \$ 2,196.9               | \$ 2,011.4  |
| Cost of sales   | 669.9                     | 634.8       | 1,958.3                  | 1,814.8     |
| Gross margin  | 65.2                      | 30.0        | 238.6                    | 196.6       |
| Selling and administrative                                  | 69.7                      | 65.3        | 217.6                    | 197.9       |
| Income from equity affiliates and minority interest         | 5.8                       | 11.7        | 24.4                     | 16.6        |
| Operating income (loss)                                     | 1.3                       | (23.6)      | 45.4                     | 15.3        |
| Interest expense  | (10.5)                    | (11.9)      | (30.4)                   | (43.2)      |
| Interest income   | 0.8                       | 1.6         | 2.5                      | 3.4         |
| Premium on early extinguishment of long-term debt           |                           | (7.5)       |                          | (12.8)      |
| Other expense, net  |                           | (1.8)       | (2.7)                    | (4.5)       |
| Income (loss) before income taxes                           | (8.4)                     | (43.2)      | 14.8                     | (41.8)      |
| Income tax (expense) benefit                                | 2.8                       | 45.5        | (5.1)                    | 46.1        |
| Net income (loss)   | \$ (5.6)                  | \$ 2.3      | \$ 9.7                   | \$ 4.3      |
| Basic and diluted earnings (loss) per common share          | \$ (0.06)                 | \$ 0.02     | \$ 0.10                  | \$ 0.05     |
| Weighted-average shares used to compute earnings per share: |                           |             |                          |             |
| Basic   | 92.9                      | 92.8        | 92.9                     | 92.7        |
| Diluted   | 92.9                      | 93.3        | 93.5                     | 93.1        |
| 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)

|  | <b>September<br/>30,<br/>2008</b> | <b>December<br/>31,<br/>2007</b> |
|--|-----------------------------------|----------------------------------|
| Assets                                       |                                   |                                  |
| Current assets:                              |                                   |                                  |
| Cash and cash equivalents                    | \$ 37.0                           | \$ 79.4                          |
| Accounts receivable, net                     | 392.4                             | 340.8                            |
| Inventories                                  | 273.1                             | 223.4                            |
| Deferred income tax assets                   | 21.9                              | 20.4                             |
| Other current assets                         | 19.7                              | 19.8                             |
| Total current assets                         | 744.1                             | 683.8                            |
| Property, net                                | 444.5                             | 449.7                            |
| Investment in equity affiliates              | 25.8                              | 19.9                             |
| Goodwill                                     | 332.8                             | 288.8                            |
| Other intangible assets, net                 | 70.4                              | 6.7                              |
| Deferred income tax assets                   | 75.0                              | 69.9                             |
| Other non-current assets                     | 67.1                              | 64.2                             |
| Total assets                                 | \$ 1,759.7                        | \$ 1,583.0                       |
| Liabilities and Shareholders' Equity         |                                   |                                  |
| Current liabilities:                         |                                   |                                  |
| Short-term bank debt                         | \$ 77.3                           | \$ 6.1                           |
| Accounts payable                             | 290.7                             | 250.5                            |
| Accrued expenses                             | 112.7                             | 94.4                             |
| Current portion of long-term debt            | 2.9                               | 22.6                             |
| Total current liabilities                    | 483.6                             | 373.6                            |
| Long-term debt                               | 388.0                             | 308.0                            |
| Post-retirement benefits other than pensions | 87.7                              | 81.6                             |
| Pension benefits                             | 62.6                              | 82.6                             |
| Other non-current liabilities                | 91.3                              | 87.8                             |
| Total liabilities                            | 1,113.2                           | 933.6                            |
| Shareholders' equity                         | 646.5                             | 649.4                            |
| Total liabilities and shareholders' equity   | \$ 1,759.7                        | \$ 1,583.0                       |

*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)

|   | <b>Nine Months Ended</b> |                |
|---|--------------------------|----------------|
|   | <b>September 30,</b>     |                |
|   | <b>2008</b>              | <b>2007</b>    |
| <b>Operating Activities</b>   |                          |                |
| Net income  | \$ 9.7                   | \$ 4.3         |
| Adjustments to reconcile net income to net cash provided by operating activities: |                          |                |
| Depreciation and amortization   | 51.8                     | 42.7           |
| Charges for environmental remediation   | 14.3                     | 47.5           |
| Cash payments for environmental remediation, net of insurance                     | (7.9)                    | (4.6)          |
| Deferred income tax benefit   | (5.1)                    | (52.2)         |
| Premium on early extinguishment of long-term debt                                 |                          | 12.8           |
| Stock-compensation expense  | 2.2                      | 3.6            |
| Asset impairment charge   |                          | 2.5            |
| Companies carried at equity and minority interest:                                |                          |                |
| Impairment of certain assets of and investment in equity affiliates               | 4.7                      | 17.5           |
| Income from equity affiliates and minority interest                               | (29.1)                   | (34.1)         |
| Dividends and distributions received  | 20.8                     | 24.2           |
| Contributions to pensions and other post-retirement plans                         | (25.5)                   | (24.2)         |
| Change in assets and liabilities, net of acquisition:                             |                          |                |
| Accounts receivable   | (69.1)                   | (52.0)         |
| Inventories   | (34.8)                   | (9.0)          |
| Accounts payable  | 36.1                     | 68.7           |
| Increase in sale of accounts receivable   | 25.8                     |                |
| Accrued expenses and other  | 23.1                     | (4.3)          |
| <b>Net cash provided by operating activities</b>                                  | <b>17.0</b>              | <b>43.4</b>    |
| <b>Investing Activities</b>   |                          |                |
| Capital expenditures  | (29.6)                   | (36.7)         |
| Investment in affiliated company  | (1.1)                    |                |
| Business acquisitions, net of cash acquired                                       | (150.2)                  | (11.0)         |
| Proceeds from sale of equity affiliate  |                          | 260.5          |
| Proceeds from sale of assets  |                          | 5.2            |
| <b>Net cash (used) provided by investing activities</b>                           | <b>(180.9)</b>           | <b>218.0</b>   |
| <b>Financing Activities</b>   |                          |                |
| Change in short-term debt   | 73.4                     | (0.2)          |
| Issuance of long-term debt, net of debt issuance costs                            | 77.8                     |                |
| Repayment of long-term debt   | (22.2)                   | (263.4)        |
| Purchase of common stock for treasury   | (8.0)                    |                |
| Premium on early extinguishment of long-term debt                                 |                          | (12.8)         |
| Proceeds from exercise of stock options   | 1.1                      | 0.9            |
| <b>Net cash provided (used) by financing activities</b>                           | <b>122.1</b>             | <b>(275.5)</b> |

|   |                |                |
|---|----------------|----------------|
| Effect of exchange rate changes on cash           | (0.6)          | 4.1            |
| Decrease in cash and cash equivalents             | (42.4)         | (10.0)         |
| Cash and cash equivalents at beginning of period  | 79.4           | 66.2           |
| <b>Cash and cash equivalents at end of period</b> | <b>\$ 37.0</b> | <b>\$ 56.2</b> |

*See Accompanying Notes to the Unaudited Condensed Consolidated Financial Statements.*

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**FINANCIAL STATEMENTS (UNAUDITED)**

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**Note 1 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, 2007 of PolyOne Corporation.

In January 2008, the Company acquired 100% of the outstanding capital stock of GLS Corporation (GLS), a global provider of specialty thermoplastic elastomer (TPE) compounds for consumer, packaging and medical applications. Identifiable intangible assets of \$66.0 million and goodwill of \$43.6 million were recorded pertaining to this acquisition. For more information on the GLS acquisition, see Note 16, Business Combination.

On July 1, 2008, PolyOne announced that, in June 2008, Producer Services, formerly included in All Other, was combined with Geon Performance Polymers to form the Performance Products and Solutions operating segment. In addition, North American Color and Additives and Specialty Inks and Polymer Systems, both formerly included in All



Other, were combined to form a new operating segment named Specialty Color, Additives and Inks. Prior period segment information has been reclassified to conform to the 2008 presentation.

On March 20, 2008, PolyOne announced the formation of the Specialty Engineered Materials segment. This segment includes PolyOne's TPE compounds product line in Europe and Asia (historically included in International Color and Engineered Materials), North American Engineered Materials (historically included in All Other) and GLS. Prior period segment information has been reclassified to conform to the 2008 presentation.

Operating results for the three-month and nine-month periods ended September 30, 2008 are not necessarily indicative of the results that may be attained in subsequent periods or for the year ending December 31, 2008.

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**Reclassification** Certain amounts for 2007 have been reclassified to conform to the 2008 presentation.

**Note 2 Accounting Policies****New Accounting Pronouncements**

**SFAS No. 157** In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements, 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. In February 2008, the FASB issued FASB Staff Position 157-2, Effective Date of FASB Statement No. 157, that delayed the effective date of SFAS No. 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis, to fiscal years beginning after November 15, 2008. The Company adopted the non-deferred portion of SFAS No. 157 on January 1, 2008, and such adoption did not have a material impact on the Company's financial statements. The Company is evaluating the effect that adoption of the deferred portion of SFAS No. 157 will have on its financial statements in 2009, specifically in the areas of measuring fair value in business combinations and goodwill impairment tests. See Note 17, Fair Value, for information on the Company's fair value assets and liabilities.

**SFAS No. 159** In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, which allows entities to voluntarily choose, at specified election dates, to measure many financial assets and liabilities at fair value. The election is made on an instrument-by-instrument basis and is irrevocable. SFAS No. 159 was effective January 1, 2008. The adoption of SFAS No. 159 had no impact on the Company's financial statements.

**SFAS No. 141 (revised 2007)** In December 2007, the FASB issued SFAS No. 141 (revised 2007), Business Combinations, which establishes principles over the method entities use to recognize and measure assets acquired and liabilities assumed in a business combination and enhances disclosures on business combinations. SFAS No. 141(R) is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008.

**SFAS No. 161** In March 2008, the FASB issued SFAS No. 161, Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133. SFAS No. 161 requires qualitative disclosures about objectives and strategies for using derivatives, quantitative disclosures about fair value amounts of and gains and losses on derivative instruments, and disclosures about credit-risk-related contingent features in derivative agreements. SFAS No. 161 is effective for fiscal years beginning after November 15, 2008.

**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 the Condensed 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 3 Goodwill and Other Intangible Assets**

In accordance with SFAS No. 141, Business Combinations, purchase accounting requires that the total purchase price of acquisitions be allocated to the fair value of assets acquired and liabilities assumed based on their fair values at the acquisition date, with amounts exceeding the fair values being recorded as goodwill. As such, the acquisition of GLS resulted in the addition of \$43.6 million of goodwill and \$66.0 million in identifiable intangibles as of September 30, 2008. See Note 16, Business Combination, for more information on the GLS acquisition.

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Goodwill as of September 30, 2008 and December 31, 2007, by operating segment, was as follows:

| (In millions)                                | <b>September<br/>30,<br/>2008</b> | <b>December<br/>31,<br/>2007</b> |
|--|-----------------------------------|----------------------------------|
| International Color and Engineered Materials | \$ 72.0                           | \$ 72.0                          |
| Specialty Engineered Materials               | 43.6                              |                                  |
| Specialty Color, Additives and Inks          | 33.8                              | 33.8                             |
| Performance Products and Solutions           | 181.8                             | 181.4                            |
| PolyOne Distribution                         | 1.6                               | 1.6                              |
| <b>Total</b>                                 | <b>\$ 332.8</b>                   | <b>\$ 288.8</b>                  |

SFAS No. 142, Goodwill and Other Intangible Assets, requires an annual assessment for potential impairment of goodwill and other intangible assets with indefinite lives. PolyOne has selected July 1 as its annual goodwill assessment date. An income approach was used to estimate the fair value of PolyOne's reporting units that supported significant goodwill, specifically: Geon Compounds; International Color and Engineered Materials; GLS; Specialty Inks and Polymer Systems; and Specialty Coatings. 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.

During the third quarter of 2008, the Company recorded a non-cash impairment charge of \$2.6 million related to the Company's proportionate share of a write-down of goodwill of Geon Polimeros Andinos, an equity affiliate (owned 50%) of the Company and part of the Performance Products and Solutions operating segment. The impairment charge, included in Income from equity affiliates and minority interest on the Condensed Consolidated Statements of Operations and reflected on the line Corporate and eliminations in Note 14, Segment Information, mainly resulted from declines in current and projected operating results and cash flows of the equity affiliate. See Note 7, Investment in Equity Affiliates, for discussion of the related impairment of the investment in Geon Polimeros Andinos during the third quarter of 2008.

As of September 30, 2008, no potential indicator of impairment exists, 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. Based upon this, PolyOne concluded that an interim assessment of goodwill as of September 30, 2008 was not required.

After completing the Company's impairment testing as of July 1, 2008, PolyOne changed the timing of the annual impairment testing to be as of October 1 of each year. The Company adopted this change to assess the recorded values of goodwill and intangible assets not subject to amortization for potential impairment at a time more coincident with the strategic business planning process and closer to the fiscal year-end reporting date. This change has no effect on reported earnings for any period presented. See Note 19, Accounting Change Goodwill and Other Indefinite-Lived Intangible Assets, for further discussion.

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Information regarding PolyOne's finite-lived other intangible assets follows:

| (In millions)                          | As of September 30, 2008 |                          |                      |         |
|--|--------------------------|--------------------------|----------------------|---------|
|  | Acquisition Cost         | Accumulated Amortization | Currency Translation | Net     |
| Non-contractual customer relationships | \$ 37.0                  | \$ (8.3)                 | \$                   | \$ 28.7 |
| Sales contract                         | 11.4                     | (10.2)                   |                      | 1.2     |
| Patents, technology and other          | 9.1                      | (3.1)                    | 1.3                  | 7.3     |
| Total                                  | \$ 57.5                  | \$ (21.6)                | \$ 1.3               | \$ 37.2 |

| (In millions)                          | As of December 31, 2007 |                          |                      |        |
|--|-------------------------|--------------------------|----------------------|--------|
|  | Acquisition Cost        | Accumulated Amortization | Currency Translation | Net    |
| Non-contractual customer relationships | \$ 8.6                  | \$ (6.7)                 | \$                   | \$ 1.9 |
| Sales contract                         | 11.4                    | (10.0)                   |                      | 1.4    |
| Patents, technology and other          | 4.7                     | (2.7)                    | 1.4                  | 3.4    |
| Total                                  | \$ 24.7                 | \$ (19.4)                | \$ 1.4               | \$ 6.7 |

Amortization of finite-lived other intangible assets was \$0.8 million and \$0.1 million for the three-month periods ended September 30, 2008 and 2007, respectively, and \$2.3 million and \$1.6 million for the nine-month periods ended September 30, 2008 and 2007, respectively. At September 30, 2008, PolyOne has \$33.2 million of indefinite-lived other intangible assets that are not subject to amortization, consisting mainly of trademarks and trade names acquired as part of the January 2, 2008 GLS acquisition, which will be tested for impairment as of October 1, 2008.

The carrying values of finite-lived 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, 2008, there were no indicators of impairment for intangible assets. 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 4 Inventories**

Components of inventories are as follows:

| (In millions)                                | September 30, 2008 | December 31, 2007 |
|--|--------------------|-------------------|
| Finished products and in-process inventories | \$ 186.4           | \$ 169.5          |
| Raw materials and supplies                   | 144.8              | 100.1             |
| LIFO reserve                                 | 331.2<br>(58.1)    | 269.6<br>(46.2)   |
| Total  | \$ 273.1           | \$ 223.4          |

**Note 5 Property**

| September 30, | December 31, |
|---------------|--------------|
|---------------|--------------|

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| (In millions)                                  | <b>2008</b> | <b>2007</b> |
|--|-------------|-------------|
| Land and land improvements                     | \$ 40.3     | \$ 40.3     |
| Buildings                                      | 277.7       | 271.8       |
| Machinery and equipment                        | 929.1       | 903.6       |
|  | 1,247.1     | 1,215.7     |
| Less accumulated depreciation and amortization | (802.6)     | (766.0)     |
|  | \$ 444.5    | \$ 449.7    |

During the third quarter of 2008, the Company recorded \$4.4 million of accelerated depreciation related to the restructuring of certain manufacturing assets. See Note 10, Employee Separation and Plant Phaseout, for further discussion.

**Table of Contents****Note 6 Income Taxes**

The effective income tax rates for the third quarter and first nine months of 2008 were 33.3% and 34.5%, respectively, compared to 105.3% and 110.3% for the same periods in 2007. The difference between the effective rates and statutory rate in 2008 is the impact of earnings in international jurisdictions with lower income tax rates and domestic losses. Included in the third quarter and first nine months of 2007 was a \$31.5 million tax benefit resulting from the reversal of deferred tax liabilities recognized upon the sale of our 24% interest in Oxy Vinyls, LP (OxyVinyls). Excluding the \$31.5 million tax benefit, the effective tax rate for the third quarter and first nine months of 2007 were 32.4% and 34.9%, respectively. The remaining difference between the effective rates and statutory rate in 2007 is the impact of earnings in international jurisdictions with lower income tax rates and domestic losses.

**Note 7 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 and, as a result, no equity affiliate earnings of OxyVinyls were recorded by PolyOne for the three months and nine months ended September 30, 2008.

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

| (Dollars in millions)                         | <b>Three Months Ended</b> |             | <b>Nine Months Ended</b> |             |
|---|---------------------------|-------------|--------------------------|-------------|
|   | <b>September 30,</b>      |             | <b>September 30,</b>     |             |
|   | <b>2008</b>               | <b>2007</b> | <b>2008</b>              | <b>2007</b> |
| Net sales                                     | \$ 43.1                   | \$ 51.9     | \$ 123.3                 | \$ 136.1    |
| Operating income                              | \$ 22.4                   | \$ 27.4     | \$ 59.9                  | \$ 67.8     |
| Partnership income as reported by SunBelt     | \$ 20.3                   | \$ 25.1     | \$ 53.6                  | \$ 61.1     |
| PolyOne's ownership of SunBelt                | 50%                       | 50%         | 50%                      | 50%         |
| Equity affiliate earnings recorded by PolyOne | \$ 10.2                   | \$ 12.6     | \$ 26.8                  | \$ 30.6     |

| (In millions)           | <b>September 30, 2008</b> | <b>December 31, 2007</b> |
|-------------------------|---------------------------|--------------------------|
| Current assets          | \$ 41.6                   | \$ 27.8                  |
| Non-current assets      | 112.1                     | 109.6                    |
| Total assets            | 153.7                     | 137.4                    |
| Current liabilities     | 20.3                      | 21.0                     |
| Non-current liabilities | 109.7                     | 109.7                    |
| Total liabilities       | 130.0                     | 130.7                    |
| Partnership capital     | \$ 23.7                   | \$ 6.7                   |

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

|   | <b>Nine Months<br/>Ended<br/>September 30,<br/>2007</b> |
|---|---|
| (Dollars in millions)   |   |
| Net sales   | \$ 1,108.3  |
| Operating income  | \$ 10.9   |
| Partnership income as reported by OxyVinyls   | \$ 2.7  |
| PolyOne's ownership of OxyVinyls  | 24%   |
| PolyOne's proportionate share of OxyVinyls' income  | 0.6   |
| Amortization of the difference between PolyOne's investment and its underlying share of OxyVinyls' equity | 0.3   |
| Equity affiliate earnings recorded by PolyOne   | \$ 0.9  |

Other investments in equity affiliates are discussed below.

The BayOne Urethane Systems, L.L.C. equity affiliate (owned 50%) is included in the Specialty Color, Additives and Inks operating segment. The Performance Products and Solutions operating segment includes the Geon Polimeros Andinos equity affiliate (owned 50%). The Altona Properties equity affiliate (owned 37.4%) is included in the Resin and Intermediates operating segment. Combined summarized financial information for these equity affiliates follows.

| (In millions)   | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|---|---|-------------|--|-------------|
|   | <b>2008</b>                                 | <b>2007</b> | <b>2008</b>                                | <b>2007</b> |
| Net sales   | \$44.8                                      | \$34.7      | \$90.6                                     | \$88.0      |
| Operating income  | \$ 0.8                                      | \$ 2.4      | \$ 5.4                                     | \$ 6.2      |
| Partnership income as reported by other equity affiliates | \$ 0.7                                      | \$ 1.8      | \$ 4.6                                     | \$ 5.8      |
| Equity affiliate earnings recorded by PolyOne             | \$ 0.3                                      | \$ 0.8      | \$ 2.3                                     | \$ 2.8      |

During the third quarter of 2008, the Company recorded a non-cash impairment charge of \$2.6 million related to the Company's proportionate share of a write-down of goodwill of Geon Polimeros Andinos, an equity affiliate (owned 50%) of the Company and part of the Performance Products and Solutions operating segment. The impairment charge, included in Income from equity affiliates and minority interest on the Condensed Consolidated Statements of Operations and reflected on the line Corporate and eliminations in Note 14, Segment Information, mainly resulted from declines in current and projected operating results and cash flows of the equity affiliate. PolyOne's proportionate share of the write-down of certain assets by Geon Polimeros Andinos was \$1.6 million in the third quarter of 2007. Also, in the third quarter of 2008 PolyOne recorded a \$2.1 million charge related to an impairment in its investment in Geon Polimeros Andinos. These impairments are not reflected in the above equity affiliate earnings because they are excluded as a measure of segment operating income or loss that is reported to and reviewed by the chief operating decision maker (See Note 14, Segment Information). These impairments are recorded in Income from equity affiliates and minority interest in the Condensed Consolidated Statements of Operations.

**Note 8 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 Statements of Operations includes compensation expense for share-based payment awards based on the grant date fair value estimated in accordance with the provision of SFAS No. 123(R), Share-Based Payment. Because share-based compensation expense recognized in the Condensed Consolidated

Statements of Operations 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.



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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 Statements of Operations. A summary of compensation expense by type of award follows:

| (In millions)                  | Three Months Ended |        | Nine Months Ended |        |
|--------------------------------|--------------------|--------|-------------------|--------|
|                                | September 30,      |        | September 30,     |        |
|                                | 2008               | 2007   | 2008              | 2007   |
| Stock appreciation rights      | \$ 0.2             | \$ 0.8 | \$ 1.1            | \$ 3.1 |
| Restricted stock units         | 0.3                |        | 0.6               |        |
| Restricted stock awards        | 0.2                | 0.2    | 0.5               | 0.5    |
| Performance shares             |                    |        |                   |        |
| Stock options                  |                    |        |                   |        |
| Total share-based compensation | \$ 0.7             | \$ 1.0 | \$ 2.2            | \$ 3.6 |

**2008 Equity and Performance Incentive Plan**

In May 2008, PolyOne's shareholders approved the PolyOne Corporation 2008 Equity and Performance Incentive Plan (2008 EPIP). This plan replaces the 2005 Equity and Performance Incentive Plan (2005 EPIP). The 2005 EPIP was frozen upon the approval of the 2008 EPIP in May 2008. The 2008 EPIP provides for the award of a 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 2008 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.

**2005 Equity and Performance Incentive Plan**

In May 2005, PolyOne's shareholders approved the 2005 EPIP. 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 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 were 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. The 2005 EPIP was replaced by the 2008 EPIP.

**Stock Appreciation Rights**

During the first nine months of 2008, the Compensation and Governance Committee of the Company's Board of Directors authorized the issuance of 1,094,400 stock appreciation rights (SARs). These awards vest in one-third increments annually over a three-year service period. These SARs have a seven-year exercise period that expires on March 6, 2015.

For SARs granted in 2007 and 2006, vesting is based on a service period of one year and the achievement of certain stock price targets. This condition is considered a market-based measure under SFAS No. 123(R) and is considered in determining the award'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 granted in 2007 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 per share, but may not be exercised earlier than one year from the date of the grant. At September 30, 2008, these awards had reached the \$8.56 stock price achievement target. The awards granted in 2006 vest in one-third increments based on stock price achievement (for a minimum of three consecutive trading days) of \$7.50, \$8.50 and \$10.00 per share, but may not be exercised earlier than one year from the date of the grant. At September 30, 2008, these awards had reached the \$8.50 stock price achievement target. These SARs have a seven-year exercise period.

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Due to the fact that the SARs granted during 2007 and 2006 vest in one-third increments based on certain stock price achievement, the option pricing model used by PolyOne to value the SARs granted during 2007 and 2006 was a Monte Carlo simulation method.

PolyOne utilized an option pricing model based on the Black-Scholes method to value the SARs granted in 2008. 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 37% based upon the historical weekly volatility of PolyOne common stock during the 4.5 years preceding the date of grant. The expected term of SARs granted was determined based on the Securities and Exchange Commission's simplified method described in Staff Accounting Bulletin (SAB) No. 107. This method results in an expected term of 4.5 years, equal to halfway between the average vesting of two years and the expiration of seven years. SAB No. 110 allows companies lacking sufficient historical exercise experience to continue use of this method. Dividends were omitted in this calculation because PolyOne does not currently pay dividends. The risk-free rate of return was based on available yields on U.S. Treasury bills of the same duration as the expected option term. 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 2008:

|                              |             |
|------------------------------|-------------|
|                              | <b>2008</b> |
| Expected volatility          | 37.00%      |
| Expected dividends           |             |
| Expected term                | 4.5 years   |
| Risk-free rate               | 2.48%       |
| Value of SAR options granted | \$ 2.26     |

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A summary of SAR activity as of September 30, 2008 and changes during the nine months then ended follows:

|   |               | <b>Weighted-<br/>Average<br/>Exercise<br/>Price</b> | <b>Weighted-<br/>Average<br/>Remaining<br/>Contractual<br/>Term</b> | <b>Aggregate<br/>Intrinsic<br/>Value</b> |
|---|---------------|---|---|--|
| (Shares in thousands, dollars in millions, except per share data) |               |   |   |  |
| <b>Stock Appreciation Rights</b>                                  | <b>Shares</b> | <b>Per Share</b>                                    |   |  |
| Outstanding at January 1, 2008                                    | 2,991         | \$ 7.30   |   |  |
| Granted   | 1,094         | 6.82  |   |  |
| Exercised   | (7)           | 6.56  |   |  |
| Forfeited or expired  | (62)          | 6.77  |   |  |
|   |               |   | 4.96  |  |
| Outstanding at September 30, 2008                                 | 4,016         | \$ 7.18   | years   | \$                                       |
|   |               |   | 4.59  |  |
| Vested and exercisable at September 30, 2008                      | 2,452         | \$ 7.16   | years   | \$                                       |

The weighted-average grant date fair value of SARs granted during the nine months ended September 30, 2008 and 2007 was \$2.28 and \$2.74, respectively. The total intrinsic value of SARs that were exercised during the nine months ended September 30, 2008 and 2007 was \$0.0 million and \$0.1 million, respectively. As of September 30, 2008, there was \$1.9 million of total unrecognized compensation cost related to SARs, which is expected to be recognized over the next 32 months.

**Restricted Stock Units**

During 2008, 477,600 restricted stock units have been granted to select executives and other key employees. A restricted stock unit (RSU) represents a contingent right to receive one share of the Company's common stock at a future date provided a continuous three-year service period is attained. Compensation expense is measured on the grant date using the quoted market price of the Company's common stock and is recognized on a straight-line basis over the requisite service period.

As of September 30, 2008, 457,142 RSUs remain unvested with a weighted-average grant date fair value of \$6.85 and a weighted-average remaining contractual term of 29 months. Unrecognized compensation cost for RSUs at September 30, 2008 was \$2.7 million.

**Restricted Stock Awards**

In 2007 and 2006, PolyOne issued restricted stock as part of the compensation package for select executives and other key employees. The value of the restricted shares was established using the market price of PolyOne's common stock on the date of grant. Compensation expense is being recorded on a straight-line basis over the three-year cliff vesting period of the restricted stock. As of September 30, 2008, 239,600 shares of restricted stock remain unvested with a weighted-average grant date fair value of \$8.66 and a weighted-average remaining contractual term of seven months. Unrecognized compensation cost for restricted stock awards at September 30, 2008 was \$0.4 million.

**Performance Shares**

In January 2005, the Compensation and Governance Committee authorized the issuance of performance shares to select executives and other key employees. The performance shares vested only to the extent that management goals for cash flow, return on invested capital, and the level of earnings before interest, taxes, depreciation and amortization in relation to debt were achieved for the period commencing January 1, 2005 and ending December 31, 2007. Of the 388,500 performance share awards outstanding at December 31, 2007, 33% vested and were paid out in shares issued from treasury, net of tax.

**Stock Options**

PolyOne's incentive stock plans previously provided for the award or grant of options to purchase PolyOne common stock. Options were granted in 2004 and prior. Options granted generally became exercisable at the rate of 35% after one year, 70% after two years and 100% after three years. The term of each option does not extend beyond 10 years from the date of grant. All options were granted at 100% or greater of market value (as defined) on the date of the grant.

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A summary of option activity as of September 30, 2008 and changes during the nine months then ended follows:

|   |               | <b>Weighted-<br/>Average<br/>Exercise<br/>Price</b> | <b>Weighted-<br/>Average<br/>Remaining<br/>Contractual<br/>Term</b> | <b>Aggregate<br/>Intrinsic<br/>Value</b> |
|---|---------------|---|---|--|
| (Shares in thousands, dollars in millions, except per share data) | <b>Shares</b> | <b>Per Share</b>                                    | <b>Term</b>   | <b>Value</b>                             |
| Outstanding at January 1, 2008                                    | 6,153         | \$ 11.17  |   |  |
| Granted   |               |   |   |  |
| Exercised   | (190)         | 5.98  |   |  |
| Forfeited or expired  | (1,716)       | 10.78   |   |  |
| Outstanding, vested and exercisable at September 30, 2008         | 4,247         | \$ 11.56  | 1.45<br>Years   | \$ 0.1                                   |

The total intrinsic value of stock options that were exercised during the nine months ended September 30, 2008 and 2007 was \$0.4 million and \$0.1 million, respectively. Cash received during the first nine months of 2008 and 2007 from the exercise of stock options was \$1.3 million and \$0.9 million, respectively.

**Note 9 Weighted-Average Shares Used in Computing Earnings Per Share**

| (In millions)                                    | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|--|---|-------------|--|-------------|
|  | <b>2008</b>                                 | <b>2007</b> | <b>2008</b>                                | <b>2007</b> |
| Weighted-average shares outstanding basic        | 92.9  | 92.8        | 92.9                                       | 92.7        |
| Weighted-average shares diluted:                 |   |             |  |             |
| Weighted-average shares outstanding basic        | 92.9  | 92.8        | 92.9                                       | 92.7        |
| Plus dilutive impact of stock options and awards |   | 0.5         | 0.6  | 0.4         |
| Weighted-average shares diluted                  | 92.9  | 93.3        | 93.5                                       | 93.1        |

Basic earnings per common share are 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. Pursuant to SFAS No. 128,

Earnings Per Share, when a loss is reported the denominator of diluted earnings per share cannot be adjusted for the dilutive impact of stock options and awards because doing so will result in anti-dilution. Therefore, for the three months ended September 30, 2008, basic weighted-average shares outstanding are used in calculating diluted earnings per share.

During the quarter ended September 30, 2008, the Company repurchased 1.0 million shares of common stock under a stock repurchase program approved by the Company's Board of Directors. See Note 18, Shareholder's Equity and Comprehensive Income (Loss), for further discussion.

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 shares underlying anti-dilutive options and awards was 4.6 million at September 30, 2008 and 6.8 million at September 30, 2007.

**Note 10 Employee Separation and Plant Phaseout**

Since the formation of PolyOne in 2000, management has undertaken certain restructuring initiatives to improve profitability and, as a result, PolyOne has incurred employee separation and plant phaseout costs. Employee separation and plant phaseout costs are reflected on the line Corporate and eliminations in Note 14, Segment Information. For further discussion of these initiatives, see Note E, Employee Separation and Plant Phaseout, to the Consolidated Financial Statements included in PolyOne's Annual Report on Form 10-K for the year ended December 31, 2007.

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On July 28, 2008, PolyOne announced the restructuring of certain manufacturing assets, primarily in North America. PolyOne will close certain production facilities, including seven in North America and one in the United Kingdom, resulting in a net reduction of approximately 150 positions. As a result of these actions, PolyOne expects to incur one-time charges of \$31 million, of which \$18 million is expected to be non-cash write-downs of assets which includes accelerated depreciation. The remaining charges include cash costs related to employee separation and severance. The following table details the charges and changes to the reserves associated with this initiative for the quarter ended September 30, 2008:

| (in millions, except employee numbers)             | Employee Separation |        | Plant Phaseout Costs |                   | Total  |
|--|---------------------|--------|----------------------|-------------------|--------|
|  | Number of Employees | Costs  | Cash Closure         | Asset Write-downs |        |
| <b>Realignment of certain manufacturing plants</b> |                     |        |                      |                   |        |
| Balance at June 30, 2008                           |                     | \$     | \$                   | \$                | \$     |
| Charge   | 252                 | 5.8    | 1.0                  | 4.8               | 11.6   |
| Utilized   | (71)                | (0.9)  | (0.8)                | (4.8)             | (6.5)  |
| Balance at September 30, 2008                      | 181                 | \$ 4.9 | \$ 0.2               | \$                | \$ 5.1 |

During the second quarter of 2008, the Company incurred \$1.1 million related to executive severance agreements, which was included in Selling and administrative in the Condensed Consolidated Statement of Operations. During the three-month and nine-month periods ended September 30, 2008, the Company paid \$0.3 million and \$0.9 million, respectively, related to executive severance agreements. PolyOne's liability for unpaid executive severance costs was \$1.1 million at September 30, 2008 and will be paid over the next 23 months.

Total employee separation and plant phaseout costs for the three- and nine-month periods ended September 30, 2008 and 2007, including where the charges are recorded in the Condensed Consolidated Statement of Operations, follow:

| (In millions)                                | Three Months Ended |        | Nine Months Ended |        |
|--|--------------------|--------|-------------------|--------|
|  | September 30,      |        | September 30,     |        |
|  | 2008               | 2007   | 2008              | 2007   |
| Cost of sales                                | \$ 11.5            | \$ 1.0 | \$ 11.9           | \$ 1.4 |
| Selling and administrative                   | 0.1                | 0.5    | 1.2               | 0.8    |
| Total employee separation and plant phaseout | \$ 11.6            | \$ 1.5 | \$ 13.1           | \$ 2.2 |

Included in the cost of sales charges for the three month and nine month periods ended September 30, 2008 was a third quarter 2008 charge of \$4.4 million for accelerated depreciation on assets related to these restructuring initiatives. Cash payments during the three-month and nine-month periods ended September 30, 2008 were \$2.1 million and \$3.3 million, respectively. Cash payments during the three-month and nine-month periods ended September 30, 2007 was \$0.4 million and \$1.2 million, respectively.

**Note 11 Employee Benefit Plans**

Components of defined benefit pension plan costs are as follows:

| (In millions) | Three Months Ended |        | Nine Months Ended |        |
|---------------|--------------------|--------|-------------------|--------|
|               | September 30,      |        | September 30,     |        |
|               | 2008               | 2007   | 2008              | 2007   |
| Service cost  | \$ 0.4             | \$ 0.2 | \$ 1.0            | \$ 0.8 |

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|  |        |        |        |        |
|--|--------|--------|--------|--------|
| Interest cost  | 8.1    | 7.3    | 24.3   | 22.5   |
| Expected return on plan assets   | (8.3)  | (7.8)  | (24.9) | (23.8) |
| Amortization of unrecognized losses, transition obligation<br>and prior service cost | 2.1    | 2.1    | 6.1    | 7.3    |
|  | \$ 2.3 | \$ 1.8 | \$ 6.5 | \$ 6.8 |

During the third quarter of 2008, the Company's Board of Directors approved the adoption of an amended and restated letter agreement with Stephen D. Newlin, the Company's Chairman, President and Chief Executive Officer, to provide



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certain benefits upon a qualifying separation from service, including annual supplemental executive retirement payments, payable in the form of a fifteen year certain and continuous life annuity, conditioned upon execution of a release and waiver. The payments are unsecured and unfunded obligations of the Company.

In connection with a settlement agreement reached in a pending legal action, the Company agreed to re-institute retiree health benefits for specified retirees of the Company on a prospective basis on January 1, 2009 or within 30 days of final approval of the settlement, whichever is later. The impacted retirees and/or their surviving spouses will be eligible, subject to certain conditions, to receive comparable benefits for which they were eligible prior to April 1, 2006.

PolyOne estimates that the minimum funding requirements in 2008 for its qualified defined benefit pension plans will approximate \$24 million of which \$18.2 million has been paid as of September 30, 2008. Funding for these plans for the year ended December 31, 2007 was \$14.9 million.

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

| (In millions)   | Three Months Ended |        | Nine Months Ended |        |
|---|--------------------|--------|-------------------|--------|
|   | September 30,      |        | September 30,     |        |
|   | 2008               | 2007   | 2008              | 2007   |
| Service cost  | \$ 0.1             | \$ 0.1 | \$ 0.3            | \$ 0.3 |
| Interest cost   | 1.5                | 1.1    | 4.5               | 3.9    |
| Expected return on plan assets  |                    |        |                   |        |
| Amortization of unrecognized losses, transition obligation and prior service cost | (1.1)              | (0.9)  | (3.3)             | (3.1)  |
|   | \$ 0.5             | \$ 0.3 | \$ 1.5            | \$ 1.1 |

**Note 12 Financing Arrangements**

**Short-term debt** On January 3, 2008, the Company entered into a credit agreement with Citicorp USA, Inc., as administrative agent and as issuing bank, and The Bank of New York, as paying agent. The credit agreement provides for an unsecured revolving and letter of credit facility with total commitments of up to \$40.0 million. The credit agreement expires on March 20, 2011. Borrowings under the revolving credit facility are based on the applicable LIBOR rate plus a fixed fee. On January 9, 2008, the Company borrowed \$40.0 million under the agreement, which is included in short-term bank debt on the Condensed Consolidated Balance Sheet at September 30, 2008.

In connection with the \$40.0 million borrowed under the revolving credit facility, the Company entered into a \$40.0 million floating to fixed interest rate swap expiring on January 9, 2009, resulting in an effective interest rate of 8.4%. This derivative is not treated as a hedge and, as a result, is marked to market, with the resulting gain and loss recognized as interest expense in the Condensed Consolidated Statements of Operations. At September 30, 2008, this agreement had a fair value obligation of less than \$0.1 million.

At September 30, 2008, \$37.3 million of short-term notes issued by certain of the Company's European subsidiaries were outstanding. This short-term debt has durations of less than one year, is renewable with the consent of both parties and is prepayable.

The weighted-average interest rate on total short-term borrowings, including the fixed rate interest rate swap discussed above, was 7.2% at September 30, 2008.

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**Long-term debt** Long-term debt consisted of the following:

| (In millions)   | September<br>30,<br>2008 <sup>(1)</sup> | December<br>31,<br>2007 <sup>(1)</sup> |
|---|---|--|
| 8.875% senior notes due 2012  | \$ 279.2                                | \$ 199.2                               |
| 7.500% debentures due 2015  | 50.0                                    | 50.0                                   |
| Medium-term notes:  |   |  |
| 7.16% medium-term note due 2008                                     |   | 9.8                                    |
| 6.89% medium-term note due 2008                                     |   | 9.8                                    |
| 6.91% medium-term note due 2009                                     | 19.7                                    | 19.2                                   |
| 6.52% medium-term note due 2010                                     | 19.5                                    | 18.8                                   |
| 6.58% medium-term note due 2011                                     | 19.4                                    | 18.5                                   |
| 6.0% promissory note due in equal monthly installments through 2009 | 3.1                                     | 5.3                                    |
| <br>  |   |  |
| Total long-term debt  | \$ 390.9                                | \$ 330.6                               |
| Less current portion  | 2.9                                     | 22.6                                   |
| <br>  |   |  |
| Total long-term debt, net of current portion                        | \$ 388.0                                | \$ 308.0                               |

<sup>(1)</sup> Book values include unamortized discounts and adjustments related to hedging instruments, as applicable.

In April 2008, PolyOne sold an additional \$80.0 million in aggregate principal amount of 8.875% senior notes due 2012. Net proceeds from the offering were used to reduce the amount of receivables previously sold under the receivables sale facility.

PolyOne repurchased \$100.0 million of its 10.625% senior notes due 2010 in June 2007 and repurchased the remaining \$141.4 million of such senior notes in August 2007. For the first nine months of 2007, the premiums paid were \$12.8 million and are shown as a separate line item in the Condensed Consolidated Statements of Operations. In addition, for the nine-month period ended September 30, 2007, unamortized deferred note issuance costs of \$2.8 million were expensed due to the debt repurchase and are included in interest expense in the Condensed Consolidated Statements of Operations.

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, 2007. There have been no material changes in the market risk faced by PolyOne from December 31, 2007 to September 30, 2008.

**Note 13 Sale of Accounts Receivable**

Accounts receivable consist of the following:

| (In millions)  | <b>September<br/>30,<br/>2008</b> | <b>December<br/>31,<br/>2007</b> |
|--|-----------------------------------|----------------------------------|
| Trade accounts receivable                            | \$ 202.6                          | \$ 169.8                         |
| Retained interest in securitized accounts receivable | 196.7                             | 175.8                            |
| Allowance for doubtful accounts                      | (6.9)                             | (4.8)                            |
|  | <b>\$ 392.4</b>                   | <b>\$ 340.8</b>                  |

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. 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. As of September 30, 2008, \$133.2 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.

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At September 30, 2008 and December 31, 2007, accounts receivable totaling \$222.5 million and \$175.8 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, 2008, PFC had sold \$25.8 million of its undivided interest in accounts receivable. At December 31, 2007, 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, 2008 and December 31, 2007. As a result, the interest retained by PolyOne of \$196.7 million and \$175.8 million is included in accounts receivable on the Condensed Consolidated Balance Sheets at September 30, 2008 and December 31, 2007, 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 \$11.8 million was used at September 30, 2008.

The facility requires PolyOne to maintain a minimum fixed charge coverage ratio of at least 1 to 1 when average excess availability under the facility is \$40.0 million or less.

**Note 14 Segment Information**

During the second quarter of 2008, PolyOne announced that Producer Services, formerly included in All Other, was combined with Geon Performance Polymers to form the Performance Products and Solutions operating segment. In addition, North American Color and Additives and Specialty Inks and Polymer Systems, both formerly included in All Other, were combined to form a new operating segment named Specialty Color, Additives and Inks.

On March 20, 2008, PolyOne announced the Specialty Engineered Materials segment. This segment includes PolyOne's TPE compounds product line in Europe and Asia (historically included in International Color and Engineered Materials), North American Engineered Materials (historically included in All Other) and GLS. On April 15, 2008, the Vinyl Business segment was re-branded to be called Geon Performance Polymers.

As a result of these changes to PolyOne's segment structure, prior period segment information was reclassified to conform to the 2008 presentation.

The accounting policies of each segment are consistent with those described in Summary of Significant Accounting Policies in Note C, Summary of Significant Accounting Policies, to the Consolidated Financial Statements included in PolyOne's Annual Report on Form 10-K for the year ended December 31, 2007.

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 certain costs. 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) 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.

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Segment information for the three- and nine-month periods ended September 30, 2008 and 2007 follows:

|   | Three Months Ended September 30,<br>2008 |                |  | Nine Months Ended September 30,<br>2008 |                |  |
|---|--|----------------|--|---|----------------|--|
|   | Sales to<br>External<br>Customers        | Total<br>Sales | Segment<br>Operating<br>Income<br>(Loss) | Sales to<br>External<br>Customers       | Total<br>Sales | Segment<br>Operating<br>Income<br>(Loss) |
| (In millions)                                   |  |                |  |   |                |  |
| International Color and<br>Engineered Materials | \$ 153.7                                 | \$ 153.7       | \$ 4.6                                   | \$ 491.0                                | \$ 491.0       | \$ 22.8                                  |
| Specialty Engineered<br>Materials               | 57.6                                     | 66.1           | 5.0                                      | 175.2                                   | 197.9          | 11.1                                     |
| Specialty Color,<br>Additives and Inks          | 59.1                                     | 60.1           | 4.7                                      | 177.1                                   | 179.3          | 11.0                                     |
| Performance Products<br>and Solutions           | 251.4                                    | 274.4          | 5.3                                      | 733.7                                   | 807.4          | 18.9                                     |
| PolyOne Distribution                            | 213.3                                    | 214.7          | 9.4                                      | 619.9                                   | 624.0          | 21.9                                     |
| Resin and Intermediates                         |  |                | 9.6                                      |   |                | 24.2                                     |
| Corporate and<br>eliminations                   |  | (33.9)         | (37.3)                                   |   | (102.7)        | (64.5)                                   |
| Total   | \$ 735.1                                 | \$ 735.1       | \$ 1.3                                   | \$ 2,196.9                              | \$ 2,196.9     | \$ 45.4                                  |

|   | Three Months Ended September 30,<br>2007 |                |  | Nine Months Ended September 30,<br>2007 |                |  |
|---|--|----------------|--|---|----------------|--|
|   | Sales to<br>External<br>Customers        | Total<br>Sales | Segment<br>Operating<br>Income<br>(Loss) | Sales to<br>External<br>Customers       | Total<br>Sales | Segment<br>Operating<br>Income<br>(Loss) |
| (In millions)                                   |  |                |  |   |                |  |
| International Color and<br>Engineered Materials | \$ 147.4                                 | \$ 147.4       | \$ 6.5                                   | \$ 441.7                                | \$ 441.7       | \$ 20.3                                  |
| Specialty Engineered<br>Materials               | 25.4                                     | 31.8           |  | 75.4                                    | 95.6           | (1.2)                                    |
| Specialty Color,<br>Additives and Inks          | 58.2                                     | 58.7           | 3.2                                      | 177.7                                   | 179.0          | 5.7                                      |
| Performance Products<br>and Solutions           | 249.0                                    | 274.5          | 12.6                                     | 760.1                                   | 840.7          | 53.2                                     |
| PolyOne Distribution                            | 184.8                                    | 185.8          | 5.3                                      | 556.5                                   | 560.3          | 16.4                                     |
| Resin and Intermediates                         |  |                | 11.2                                     |   |                | 27.5                                     |
| Corporate and<br>eliminations                   |  | (33.4)         | (62.4)                                   |   | (105.9)        | (106.6)                                  |
| Total   | \$ 664.8                                 | \$ 664.8       | \$ (23.6)                                | \$ 2,011.4                              | \$ 2,011.4     | \$ 15.3                                  |

Segment assets at September 30, 2008 are as follows:

| (In millions)                                | <b>Total Assets</b> |
|--|---------------------|
| International Color and Engineered Materials | \$ 408.9            |
| Specialty Engineered Materials               | 233.2               |
| Specialty Color, Additives and Inks          | 159.7               |
| Performance Products and Solutions           | 574.1               |
| PolyOne Distribution                         | 212.0               |
| Resin and Intermediates                      | 12.9                |
| Corporate and eliminations                   | 158.9               |
| <br>Total                                    | <br>\$ 1,759.7      |

**Note 15 Commitments and Contingencies**

PolyOne has been notified by certain federal and state environmental agencies and by private parties that it may be a potentially responsible party (PRP) in connection with the investigation and remediation of certain environmental waste disposal sites. While government agencies frequently assert that PRPs are jointly and severally liable at these sites, in PolyOne's experience, the interim and final allocations of liability costs are generally made based on the relative contribution of waste. PolyOne believes that its potential continuing liability with respect to these sites will not have a material adverse effect on its consolidated financial position, results of operations or cash flows. In addition, PolyOne initiates corrective and preventive environmental projects of its own to ensure safe and lawful activities at its operations. PolyOne believes that compliance with current governmental regulations at all levels will not have a material adverse effect on its financial condition.

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During the nine-month periods ended September 30, 2008 and 2007, PolyOne recorded \$14.3 million and \$47.5 million, respectively, of expense related to environmental activities at all of its active and inactive sites. During these same periods, PolyOne did not receive any proceeds from insurance recoveries.

Based on estimates that were prepared by its environmental engineers and consultants, PolyOne had accruals totaling \$89.8 million at September 30, 2008 and \$83.8 million at December 31, 2007 to cover probable future environmental expenditures related to previously contaminated sites. The accrual represents PolyOne's best estimate of the remaining probable remediation costs, based upon information and technology that is currently available and PolyOne's view of the most likely remedy. Depending upon the results of future testing, the ultimate remediation alternatives undertaken, changes in regulations, new information, newly discovered conditions and other factors, it is reasonably possible that PolyOne could incur additional costs in excess of the amount accrued at September 30, 2008. However, such additional costs, if any, cannot be currently estimated. PolyOne's estimate of the liability may be revised as new regulations or technologies are developed or additional information is obtained. Additional information related to environmental liabilities is in Note N, Commitments and Related-Party Information, to the Consolidated Financial Statements included in PolyOne's Annual Report on Form 10-K for the year ended December 31, 2007.

PolyOne guarantees \$60.9 million of SunBelt's outstanding senior secured notes in connection with the construction of a chlor-alkali facility in McIntosh, Alabama. This debt matures in 2017.

**Note 16 Business Combination*****Acquisition***

On January 2, 2008, the Company acquired 100% of the outstanding capital stock of GLS, a global provider of specialty TPE compounds for consumer, packaging and medical applications, for a cash purchase price of \$148.9 million including acquisition costs and net of cash received. GLS, with sales of \$128.8 million for the year ended December 31, 2007, has been fully integrated into the Specialty Engineered Materials segment. This acquisition complements PolyOne's global engineered materials business portfolio and accelerates the Company's shift to specialization. The combination of GLS's specialized TPE offerings, compounding expertise and brand, along with PolyOne's extensive global infrastructure and commercial presence offers customers: enhanced technologies; a broader range of products, services and solutions; and expanded access to specialized, high-growth markets around the globe. The combinations of these factors are the drivers behind the excess of the purchase price over the fair value of the tangible assets and liabilities acquired.

***Allocation of Purchase Price***

The GLS acquisition was accounted for as a purchase business combination. Assets acquired and liabilities assumed are recorded in the accompanying Condensed Consolidated Balance Sheet at their estimated fair values as of January 2, 2008. Operating results of GLS are included in the Condensed Consolidated Statement of Operations from the date of acquisition. The preliminary allocation of purchase price to the assets acquired and liabilities assumed at the date of acquisition is presented in the below table. This allocation is based upon valuations using management's best estimates and assumptions. The purchase price is preliminary and a final determination of fair value will be made upon completion of appraisals of the long-lived tangible and intangible assets and liabilities. The resulting goodwill is anticipated to be fully deductible for income tax purposes.

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The identifiable intangible assets subject to amortization, totaling \$32.8 million, consist primarily of customer relationships and will be amortized over 20 years. The identifiable intangible assets not subject to amortization, totaling \$33.2 million, consist primarily of trademarks and trade names.

| (In millions)                  | <b>January 2,<br/>2008</b> |
|--------------------------------|----------------------------|
| Current assets                 | \$ 33.0                    |
| Property, plant and equipment  | 17.2                       |
| Identifiable intangible assets | 66.0                       |
| Goodwill                       | 43.6                       |
| Liabilities assumed            | (9.0)                      |
| Net assets acquired            | \$ 150.8                   |
| Less cash acquired             | (1.9)                      |
| Purchase price, net            | \$ 148.9                   |

**Note 17 Fair Value**

The following table summarizes the Company's assets and liabilities that are measured at fair value on a recurring basis subsequent to initial recognition.

| (In millions)                 | <b>Fair Value at<br/>September 30,<br/>2008</b> | <b>Quoted Prices<br/>in<br/>Active<br/>Markets for<br/>Identical<br/>Assets<br/>(Level 1)</b> | <b>Significant<br/>Other<br/>Observable<br/>Inputs<br/>(Level 2)</b> |
|-------------------------------|---|---|--|
| <b>Description</b>            |   |   |  |
| Available-for-sale securities | \$ 0.2  | \$ 0.2  | \$   |
| Interest rate swaps           |   |   |  |
| Foreign exchange contracts    | 1.1   |   | 1.1  |

**Note 18 Shareholders Equity and Comprehensive Income (Loss)**

The following table sets forth the reconciliation of net income (loss) to comprehensive income (loss):

| (In millions)  | <b>Three Months Ended<br/>September 30,<br/>2008</b> |             | <b>Nine Months Ended<br/>September 30,<br/>2008</b> |             |
|--|--|-------------|---|-------------|
|  | <b>2008</b>  | <b>2007</b> | <b>2008</b>   | <b>2007</b> |
| Net income (loss)  | \$ (5.6)   | \$ 2.3      | \$ 9.7  | \$ 4.3      |
| Amortization of unrecognized losses, transition obligation and prior service costs | 0.6  | 3.6         | 1.8   | 5.6         |
| Adjustment for plan amendment  | (3.9)  |             | (3.9)   |             |
| Adjustment for supplemental executive retirement plan                              | (1.3)  |             | (1.3)   |             |
| Translation adjustment   | (13.3)   | 10.0        | (4.6)   | 22.0        |
| Unrecognized loss on available-for-sale securities                                 | (0.2)  |             | (0.6)   |             |
| Total comprehensive income (loss)  | \$ (23.7)  | \$ 15.9     | \$ 1.1  | \$ 31.9     |



In August 2008, the Company's Board of Directors approved a stock repurchase program authorizing the Company, depending upon market conditions and other factors, to repurchase up to 10.0 million shares of its common stock, in the open market or in privately negotiated transactions.

During the quarter ended September 30, 2008, the Company repurchased 1.0 million shares of common stock under this program at an average price of \$7.93 per common share for approximately \$8.0 million. There are 9.0 million shares available for repurchase under the program at September 30, 2008.

**Note 19 Accounting Change Goodwill and Other Indefinite-Lived Intangible Assets**

PolyOne has performed its annual impairment testing of goodwill as of July 1 in each year since the adoption of SFAS No. 142, Goodwill and Other Intangible Assets. After completing the Company's impairment testing as of July 1, 2008, the Company changed its timing of the annual impairment testing to be as of October 1 of each year. The

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Company adopted this change to assess the recorded values of goodwill and intangible assets not subject to amortization for potential impairment at a time more coincident with the Company's strategic business planning process and closer to the Company's fiscal year-end reporting date. This change has no effect on reported earnings for any period presented.

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations****Overview**

We are a premier global provider of specialized polymer materials, services and solutions with operations in thermoplastic compounds, specialty polymer formulations, color and additive systems, thermoplastic resin distribution and specialty vinyl resins, with equity investments in manufacturers of caustic soda and chlorine, and polyvinyl chloride (PVC) compound products and in a formulator of polyurethane compounds. Headquartered in Avon Lake, Ohio, we have employees at manufacturing sites and distribution facilities in North America, Europe, Asia and Australia and joint ventures in North America and South America. We provide value to our customers through our ability to link our knowledge of polymers and formulation technology with our manufacturing and supply chain to provide an essential link between large chemical producers (our raw material suppliers) and designers, assemblers and processors of plastics (our customers).

Our historical presentation of segment information consisted of four reportable segments: Vinyl Business; International Color and Engineered Materials; PolyOne Distribution; and Resin and Intermediates. Additionally, the operating segments that did not meet the threshold for separate disclosure as reportable segments, North American Color and Additives, North American Engineered Materials, Producer Services and Specialty Inks and Polymer Systems operating segments, were reported in All Other.

On March 20, 2008, we announced the Specialty Engineered Materials segment. This segment includes our thermoplastic elastomer (TPE) compounds product line in Europe and Asia (historically included in International Color and Engineered Materials), North American Engineered Materials (historically included in All Other) and GLS Corporation (GLS).

On April 15, 2008, the Vinyl Business segment was re-branded to be Geon Performance Polymers.

During the second quarter of 2008, we announced that Producer Services, formerly included in All Other, was combined with Geon Performance Polymers to form the Performance Products and Solutions operating segment. In addition, North American Color and Additives and Specialty Inks and Polymer Systems, both formerly included in All Other, were combined to form a new operating segment named Specialty Color, Additives and Inks.

We currently operate within six operating segments, all of which are reportable segments: International Color and Engineered Materials; Specialty Engineered Materials; Specialty Color, Additives and Inks; Performance Products and Solutions; PolyOne Distribution; and Resin and Intermediates.

Prior period results of operations have been reclassified to conform to the 2008 presentation. We discuss the sales and operating income of our operating segments in the Segment Information section below. Also, see Note 14, Segment Information, to the Condensed Consolidated Financial Statements for further information regarding our reportable operating segments.

**Purchase of Business** In January 2008, we acquired 100% of the outstanding capital stock of GLS, a global provider of specialty TPE compounds for consumer, packaging and medical applications. The acquisition resulted in \$66.0 million of identifiable intangible assets and \$43.6 million in goodwill. For more information on the GLS acquisition, see Note 16, Business Combination, to the Condensed Consolidated Financial Statements.

**OxyVinyls Divestment** On July 6, 2007, we sold our 24% interest in Oxy Vinyls, LP (OxyVinyls) for \$260.5 million in cash. Proceeds from the sale were used for the redemption of the entire balance of our 10.625% senior notes due 2010 as well as for the reduction of drawings on short-term facilities.

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**Restructuring** On July 28, 2008, we announced that we will restructure certain manufacturing assets, primarily in North America. Over the next six months, we will close certain production facilities, including seven in North America and one in the United Kingdom, resulting in a net reduction of approximately 150 positions. As a result of these actions, we expect to incur one-time charges of \$31 million, of which \$18 million is expected to be non-cash write-downs of assets, with the remaining cash costs related to employee separation and severance. See Note 10, Employee Separation and Plant Phaseout, to the Condensed Consolidated Financial Statements.

***Outlook***

While our results for the third quarter were modestly better than anticipated, our fourth quarter earnings may fall short of our previous expectations. Accordingly, it may be a challenge to deliver full-year earnings per share within the range of previous guidance.

We are lowering our earnings expectations as a result of latent supply and pricing uncertainties associated with the Gulf storms. We are also concerned about the recent deterioration in the global economy. We expect further pressure on our international results as it is becoming increasingly clear that European and Asian demand is slowing and as the Euro continues to weaken relative to the U.S. Dollar. Additionally, the U.S. economy is under tremendous strain on the heels of the global financial crisis, creating significant uncertainty over the next few quarters for our customers. In particular, such key PolyOne end markets as housing, construction, automotive and electronics face particularly troubling business conditions which we expect may reverberate throughout other markets as the global economic slowdown gains momentum.

In reaction to the uncertainties described above, PolyOne is taking actions to reduce spending and preserve liquidity. We had expected to spend between \$55 million and \$60 million for capital expenditures including the incremental \$6 million to \$7 million we will incur this year as a result of manufacturing realignment actions announced in July. Without limiting spending related to the realignment we are now forecasting to spend less than \$55 million in capital expenditures for the year.

The fourth quarter is typically our strongest cash flow quarter and we expect that to be the case this year. Given our concerns about the economy we will be prioritizing free cash flow first for required short term debt repayments and second to ensuring we have adequate liquidity to fund seasonal working capital requirements. We will then consider additional capital expenditures beyond maintenance levels prior to furthering our overall capital structure objectives.

**Results of Operations*****Summary of Consolidated Results:***

Aggregate sales increased 10.6% in the third quarter of 2008 and 9.2% in the first nine months of 2008 versus the comparable periods in 2007. Sales from the recently acquired GLS business accounted for 5.6 percentage points and 5.3 percentage points of the increase in the third quarter and first nine months of 2008, respectively. The remainder of the increase was driven by higher sales in PolyOne Distribution and the favorable impact from foreign exchange, both of which accounted for 6.4 percentage points and 6.7 percentage points of the overall increase in sales for the third quarter and the first nine months of 2008, respectively. The International Color and Engineered Materials segment increased sales \$6.3 million and \$49.3 million in the third quarter of 2008 and the first nine months of 2008, respectively. The impact of foreign exchange accounted for \$13.1 million and \$52.2 million of the increases in sales for this segment. Sales for the Performance Products and Solutions segment for the third quarter of 2008 were slightly lower compared to the prior year and 4.0% lower in the first nine months of 2008 as compared to the same period in 2007. This decline was due mainly to lower demand in the North American residential construction and automotive markets which offset \$14.7 million of favorable foreign exchange impact in the first nine months of 2008.

Operating income increased \$24.9 million, or 105.5%, in the third quarter of 2008 versus the third quarter of 2007.

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A summary of the improvements and declines in segment operating income and Corporate and eliminations for the three months ended September 30, 2008 as compared to the three months ended September 30, 2007 is shown below:

| (Dollars in millions)                                 | <b>Three Months Ended September 30, 2008</b> |                 | <b>Segments with Declines in Operating Income</b> | <b>Three Months Ended September 30, 2007</b> |                 |
|---|--|-----------------|---|--|-----------------|
|   | <b>Change</b>                                | <b>% Change</b> |   | <b>Change</b>                                | <b>% Change</b> |
| <b>Segments with Improvements in Operating Income</b> |  |                 |   |  |                 |
| Specialty Engineered Materials                        | \$ 5.0                                       | NM              | International Color and Engineered Materials      | \$(1.9)                                      | (29.2)%         |
| Specialty Color, Additives and Inks                   | 1.5  | 46.9%           | Performance Products and Solutions                | (7.3)  | (57.9)%         |
| PolyOne Distribution                                  | 4.1  | 77.4%           | Resin and Intermediates                           | (1.6)  | (14.3)%         |
| Corporate and eliminations                            | 25.1   | 40.2%           |   |  |                 |

NM Not meaningful

Corporate and eliminations was \$25.1 million lower in third quarter of 2008 versus the third quarter of 2007 mainly due to lower environmental remediation charges partially offset by higher restructuring charges. In the third quarter of 2008, we recorded environmental remediation, restructuring and impairment charges of \$26.7 million as compared to the \$51.2 million of similar charges recorded in the third quarter of 2007.

The decline in the operating incomes of the Performance Products and Solutions segment and the Resin and Intermediates segment in the third quarter of 2008 was due mainly to weak demand in the North American residential building and construction market; higher raw material costs; and the combined effect of Hurricanes Gustav and Ike. Due to these two hurricanes, OxyVinyls declared that it was unable to perform under its supply agreement under the agreement's force majeure provision, which negatively impacted Sunbelt's shipments for chlorine and caustic soda. The impact of foreign exchange increased total company operating income \$0.9 million in the third quarter of 2008 as compared to the same period in 2007.

A summary of the improvements and declines in segment operating income and Corporate and eliminations for the nine months ended September 30, 2008 as compared to the nine months ended September 30, 2007 is shown below:

| (Dollars in millions)                                 | <b>Nine Months Ended September 30, 2008</b> |                 | <b>Segments with Declines in Operating Income</b> | <b>Nine Months Ended September 30, 2007</b> |                 |
|---|---|-----------------|---|---|-----------------|
|   | <b>Change</b>                               | <b>% Change</b> |   | <b>Change</b>                               | <b>% Change</b> |
| <b>Segments with Improvements in Operating Income</b> |   |                 |   |   |                 |
| International Color and Engineered Materials          | \$ 2.5                                      | 12.3%           | Performance Products and Solutions                | \$(34.3)                                    | (64.5)%         |
| Specialty Engineered Materials                        | 12.3  | NM              | Resin and Intermediates                           | (3.3)                                       | (12.0)%         |
| Specialty Color, Additives and Inks                   | 5.3   | 93.0%           |   |   |                 |
| PolyOne Distribution                                  | 5.5   | 33.5%           |   |   |                 |

|                            |      |       |
|----------------------------|------|-------|
| Corporate and eliminations | 42.1 | 39.5% |
|----------------------------|------|-------|

NM Not meaningful

Corporate and eliminations was \$42.1 million lower in the first nine months of 2008 versus the first nine months of 2007 due to lower environmental remediation and impairment charges partially offset by higher restructuring charges. In the first nine months of 2008, we recorded environmental remediation, restructuring and impairment charges of \$32.1 million as compared to the \$69.7 million of similar charges recorded in the first nine months of 2007.

The decline in operating incomes of the Performance Products and Solutions segment and the Resin and Intermediates segment was due mainly to continued weak demand conditions in the North American residential building and construction market and higher raw material costs. The impact of foreign exchange in the first nine months of 2008 increased total company operating income \$3.6 million.

Net income decreased \$7.9 million in the third quarter of 2008, or \$0.08 per share, compared to the same period in 2007. The third quarter 2007 benefit from the reversal of a deferred tax liability of \$31.5 million, related to the sale of an equity affiliate, offset the favorable impact of the 105.5% improvement in operating income discussed above as well as lower interest and debt repurchase premium costs in third quarter 2008. For the first nine months of 2008, net income increased \$5.4 million, or \$0.05 per share, as compared to the same period in 2007. This increase was the result of the 196.7% increase in operating income discussed above and lower interest and debt repurchase premium costs.

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The following table sets forth key financial information from our Statements of Operations for the three-month and nine-month periods ended September 30, 2008 and 2007, respectively.

| (In millions, except per share data)               | <b>Three months<br/>ended<br/>September 30,</b> |             | <b>Nine months ended<br/>September 30,</b> |             |
|--|---|-------------|--|-------------|
|  | <b>2008</b>                                     | <b>2007</b> | <b>2008</b>                                | <b>2007</b> |
| Sales  | \$ 735.1  | \$ 664.8    | \$ 2,196.9                                 | \$ 2,011.4  |
| Operating income (loss)                            | \$ 1.3  | \$ (23.6)   | \$ 45.4                                    | \$ 15.3     |
| Interest expense                                   | (10.5)  | (11.9)      | (30.4)                                     | (43.2)      |
| Interest income                                    | 0.8   | 1.6         | 2.5  | 3.4         |
| Premium on early extinguishment of long-term debt  |   | (7.5)       |  | (12.8)      |
| Other expense, net                                 |   | (1.8)       | (2.7)                                      | (4.5)       |
| Income (loss) before income taxes                  | (8.4)   | (43.2)      | 14.8                                       | (41.8)      |
| Income tax (expense) benefit                       | 2.8   | 45.5        | (5.1)                                      | 46.1        |
| Net income (loss)                                  | \$ (5.6)  | \$ 2.3      | \$ 9.7                                     | \$ 4.3      |
| Basic and diluted earnings (loss) per common share | \$ (0.06)                                       | \$ 0.02     | \$ 0.10                                    | \$ 0.05     |

**Table of Contents****Income before Income Taxes**

The following table sets forth the components of the variance for the three and nine months ended September 30, 2008 as compared to the same periods in the prior year:

|  | <b>Variances Favorable (Unfavorable)</b> |               |
|--|--|---------------|
|  | <b>Periods ended</b>                     |               |
|  | <b>September 30, 2008 and 2007</b>       |               |
|  | <b>Three</b>                             | <b>Nine</b>   |
|  | <b>Months</b>                            | <b>Months</b> |
| (In millions)  |  |               |
| Operating segment performance                                      |  |               |
| International Color and Engineered Materials                       | \$ (1.9)                                 | \$ 2.5        |
| Specialty Engineered Materials                                     | 5.0                                      | 12.3          |
| Specialty Color, Additives and Inks                                | 1.5                                      | 5.3           |
| Performance Products and Solutions                                 | (7.3)                                    | (34.3)        |
| PolyOne Distribution   | 4.1                                      | 5.5           |
| Resin and Intermediates  | (1.6)                                    | (3.3)         |
| Environmental remediation costs                                    | 19.6                                     | 17.6          |
| Reimbursement to Goodrich Corporation of environmental costs       | 15.6                                     | 15.6          |
| Impairment of OxyVinyls equity investment                          |  | 15.9          |
| Employee separation and plant phaseout                             | (10.1)                                   | (10.9)        |
| Share-based compensation   | 0.3                                      | 1.4           |
| Recognition of inventory step-up associated with GLS acquisition   |  | (1.6)         |
| Settlement of legal issues and related reserves                    | 2.4                                      | 2.4           |
| Impairment of intangibles and other investments                    | 2.5                                      | 2.5           |
| Write-down of certain assets of and investment in equity affiliate | (3.1)                                    | (3.1)         |
| All other and eliminations   | (2.1)                                    | 2.3           |
| Total Corporate and eliminations                                   | 25.1                                     | 42.1          |
| Change in operating income   | 24.9                                     | 30.1          |
| Premium on early extinguishment of debt                            | (a) 7.5                                  | (a) 12.8      |
| Interest expense, net  | (b) 0.6                                  | (b) 11.9      |
| Other expense  | 1.8                                      | 1.8           |
| Change in income (loss) before income taxes                        | \$ 34.8                                  | \$ 56.6       |

(a) We repurchased all of our 10.625% senior notes due 2010 through early extinguishment, repurchasing \$100.0 million and \$141.4 million

in the second quarter of 2007 and third quarter of 2007, respectively, at a premium of \$5.3 million and \$7.5 million, respectively.

- (b) The early extinguishment of the 10.625% senior notes resulted in lower interest expense during the three month and nine month periods ended September 30, 2008 as compared to the same periods a year ago. Included in interest expense was unamortized deferred note issuance costs of \$1.2 million and \$1.6 million during the second quarter of 2007 and the third quarter of 2007, respectively.

See the following operating segment discussion for a further explanation of our segments operating results for the periods shown in the preceding table.

**Selected Operating Costs**

Selected operating costs, expressed as a percentage of sales, are as follows:

| (Dollars in millions)    | Three Months Ended<br>September 30, |         | Nine Months Ended<br>September 30, |           |
|--------------------------|-------------------------------------|---------|------------------------------------|-----------|
|                          | 2008                                | 2007    | 2008                               | 2007      |
| Cost of sales            | \$669.9                             | \$634.8 | \$1,958.3                          | \$1,814.8 |
| As a percentage of sales | 91.1%                               | 95.5%   | 89.1%                              | 90.2%     |



**Cost of Sales** These costs include raw materials, plant conversion, distribution, environmental remediation and plant related restructuring charges. The decline in these costs on a percentage of sales basis reflects the realization of pricing initiatives and sales mix improvements to partially offset higher raw material costs and year over year differences in environmental remediation and plant related restructuring costs. In the third quarter and first nine months of 2008, we recorded \$21.9 million and \$26.2 million, respectively, of restructuring and environmental charges as compared to \$46.6 million and \$48.9 million of similar costs in the same periods for 2007.

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***Selling and Administrative*** These costs include selling, technology, administrative functions and, corporate and general expenses. Selling and administrative costs increased \$4.4 million, or 6.7%, for the three months ended September 30, 2008 compared to the same period in 2007. During the first nine months of 2008, selling and administrative costs increased \$19.7 million, or 10.0%, as compared to the first nine months of 2007. The following table sets forth the components of the variance for the three and nine months ended September 30, 2008 as compared to the same periods in the prior year:

| (In millions)  | <b>Variances Favorable<br/>(Unfavorable)<br/>Periods ended</b> |                        |
|--|--|------------------------|
|  | <b>September 30, 2008 and 2007<br/>Three<br/>Months</b>        | <b>Nine<br/>Months</b> |
| Selling and administrative                                   |  |                        |
| Employee separation and executive severance                  | \$ 0.4   | \$ (0.4)               |
| Settlement of legal issues and related reserves              | 2.4  | 2.4                    |
| Impairment of intangibles and other investments              | 2.5  | 2.5                    |
| GLS selling and administrative                               | (4.3)  | (13.3)                 |
| Increase in commercial, technical and operational excellence | (3.9)  | (4.6)                  |
| Impact of foreign exchange                                   | (1.5)  | (6.3)                  |
| Total  | \$ (4.4)   | \$ (19.7)              |

**Other Components of Income and Expense**

Discussions of significant components of income and expense that are presented below the line Operating income in the Condensed Consolidated Statements of Operations are provided below.

***Interest expense*** The decreases in interest expense of \$1.4 million and \$12.8 million for the three-month and nine-month periods ended September 30, 2008 as compared to the same periods in 2007 were due primarily to the repurchase of \$241.4 million of our 10.625% senior notes due 2010 in 2007 and the related write-offs of unamortized deferred note issuance costs associated with these senior notes.

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**Other expense, net** The following table lists the major items included in other expense, net:

| (In millions)                          | Three Months Ended |          | Nine Months Ended |          |
|--|--------------------|----------|-------------------|----------|
|  | September 30,      |          | September 30,     |          |
|  | 2008               | 2007     | 2008              | 2007     |
| Currency exchange gain (loss)          | \$ 1.2             | \$ (1.1) | \$ 1.4            | \$ (2.5) |
| Foreign exchange contracts (loss) gain | (0.4)              | 0.1      | (0.9)             | 0.6      |
| Discount on sale of trade receivables  | (0.6)              | (0.5)    | (2.8)             | (1.5)    |
| Other loss                             | (0.2)              | (0.3)    | (0.4)             | (1.1)    |
| Other expense, net                     | \$                 | \$ (1.8) | \$ (2.7)          | \$ (4.5) |

**Income tax expense** The effective income tax rates for the third quarter and first nine months of 2008 were 33.3% and 34.5%, respectively, compared to 105.3% and 110.3% for the same periods in 2007. The difference between the effective rates and statutory rate in 2008 is the impact of earnings in international jurisdictions with lower income tax rates and domestic losses. Included in the third quarter and first nine months of 2007 was a \$31.5 million tax benefit resulting from the reversal of deferred tax liabilities recognized upon the sale of our 24% interest in OxyVinyls. Excluding the \$31.5 million tax benefit, the effective tax rate for the third quarter and first nine months of 2007 were 32.4% and 34.9%, respectively. The remaining difference between the effective rates and statutory rate is the impact of earnings in international jurisdictions with lower income tax rates and domestic losses.

**Segment Information:**

**Sales and Operating Income (Loss) Three Months Ended September 30, 2008 compared with Three Months Ended September 30, 2007:**

| (Dollars in millions)                        | Three Months Ended |          |          | % Change |
|--|--------------------|----------|----------|----------|
|  | September 30,      |          |          |          |
|  | 2008               | 2007     | Change   |          |
| Sales:                                       |                    |          |          |          |
| International Color and Engineered Materials | \$ 153.7           | \$ 147.4 | \$ 6.3   | 4.3%     |
| Specialty Engineered Materials               | 66.1               | 31.8     | 34.3     | 107.9%   |
| Specialty Color, Additives and Inks          | 60.1               | 58.7     | 1.4      | 2.4%     |
| Performance Products and Solutions           | 274.4              | 274.5    | (0.1)    | 0.0%     |
| PolyOne Distribution                         | 214.7              | 185.8    | 28.9     | 15.6%    |
| Corporate and eliminations                   | (33.9)             | (33.4)   | (0.5)    | (1.5)%   |
|  | \$ 735.1           | \$ 664.8 | \$ 70.3  | 10.6%    |
| Operating income (loss):                     |                    |          |          |          |
| International Color and Engineered Materials | \$ 4.6             | \$ 6.5   | \$ (1.9) | (29.2)%  |
| Specialty Engineered Materials               | 5.0                |          | 5.0      | NM       |
| Specialty Color, Additives and Inks          | 4.7                | 3.2      | 1.5      | 46.9%    |
| Performance Products and Solutions           | 5.3                | 12.6     | (7.3)    | (57.9)%  |
| PolyOne Distribution                         | 9.4                | 5.3      | 4.1      | 77.4%    |
| Resin and Intermediates                      | 9.6                | 11.2     | (1.6)    | (14.3)%  |
| Corporate and eliminations                   | (37.3)             | (62.4)   | 25.1     | 40.2%    |

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\$ 1.3      \$ (23.6)      \$ 24.9      105.5%

Operating income (loss) as a percentage of sales:

|   |      |        |                       |
|---|------|--------|-----------------------|
| International Color and Engineered Materials    | 3.0% | 4.4%   | (1.4)% points         |
| Specialty Engineered Materials                  | 7.6% | 0.0%   | 7.6% points           |
| Specialty Color, Additives and Inks             | 7.8% | 5.5%   | 2.3% points<br>(2.7)% |
| Performance Products and Solutions              | 1.9% | 4.6%   | points                |
| PolyOne Distribution                            | 4.4% | 2.9%   | 1.5% points           |
| Total operating income as a percentage of sales | 0.2% | (3.5)% | 3.7% points           |

NM Not meaningful

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A summary of Corporate and eliminations included in Operating income (loss) is as follows:

| (In millions)  | <b>Three Months Ended</b> |                  |
|--|---------------------------|------------------|
|  | <b>September 30,</b>      |                  |
|  | <b>2008</b>               | <b>2007</b>      |
| Environmental remediation costs (a)  | \$ (10.4)                 | \$ (30.0)        |
| Employee separation and plant phaseout (b)   | (11.6)                    | (1.5)            |
| Reimbursement to Goodrich Corporation of environmental costs related to Calvert City (c) |                           | (15.6)           |
| Impairment of intangibles and other investments  |                           | (2.5)            |
| Settlement of legal issues and related reserves  |                           | (2.4)            |
| Write-down of certain assets of and investment in equity affiliate (d)                   | (4.7)                     | (1.6)            |
| Share-based compensation   | (0.7)                     | (1.0)            |
| All other and eliminations   | (9.9)                     | (7.8)            |
| <b>Total Corporate and eliminations</b>  | <b>\$ (37.3)</b>          | <b>\$ (62.4)</b> |

(a) In the third quarter of 2007, our accrual for costs related to future remediation at inactive or formerly owned sites was adjusted based on a U.S. District Court's rulings on several motions in the case of Westlake Vinyls, Inc. v. Goodrich Corporation et al. and a settlement agreement entered into in connection with the case, which requires us to pay remediation costs related to the Calvert City facility.

- (b) During the third quarter of 2008, we announced that the restructuring of certain manufacturing assets, primarily in North America. See Note 10, Employee Separation and Plant Phaseout, for further information.
  
- (c) In the third quarter of 2007, we accrued \$15.6 million to reimburse Goodrich Corporation for remediation costs paid on its behalf and certain legal costs related to the Calvert City facility.
  
- (d) In the third quarter of 2008 and 2007, we recorded \$2.6 million and \$1.6 million, respectively, related to our proportionate share of the write-down of certain assets by Geon Polimeros Andinos, our equity affiliate in Columbia. Also, in the third quarter of 2008, we

recorded a  
\$2.1 million  
charge related to  
an impairment  
of our  
investment in  
the equity  
affiliate.

**International Color and Engineered Materials**

Sales in the third quarter of 2008 increased \$6.3 million, or 4.3%, due to favorable foreign exchange, which offset a slowdown in demand in both Europe and Asia. Foreign exchange increased sales \$13.1 million. Volume was 10% lower in 2008 versus 2007. Asian sales were slightly down year to year due to softening demand for electrical and electronics products. Sales in Europe increased 5.7% driven by favorable foreign exchange, which offset softer demand in automotive, construction, packaging and textile end markets.

Operating income declined \$1.9 million, or 29.2%, in the third quarter of 2008 compared to the third quarter of 2007. Slowing demand in Europe and Asia, as discussed above, negatively impacted the sales mix particularly in specialty color and electrical and electronics applications. Increasing raw material costs were offset with price increases. Foreign exchange had a \$0.5 million favorable impact on operating income.

**Specialty Engineered Materials**

Sales increased \$34.3 million, or 107.9%, in the third quarter of 2008 as compared to the third quarter of 2007 primarily due to sales from GLS of \$37.5 million. GLS continued to grow its mix of applications in the health care, consumer products and medical end markets. This increase in sales driven by GLS was offset by softness in demand for wire & cable compounds and general purpose compounds that go into the building and construction and automotive end markets in North America and Europe.

Operating income improved \$5.0 million in the third quarter of 2008 as compared to the third quarter of 2007, primarily driven by the GLS acquisition. The non-acquired portion of the business continued to improve its mix through the capture of specialty applications and implementation of pricing initiatives to offset rising raw materials despite softening demand in the non-GLS portions of the business.

**Specialty Color, Additives and Inks**

Sales for the third quarter of 2008 increased \$1.4 million, or 2.4%, from the third quarter of 2007 despite a 7% decline in volume. A more specialized sales mix and pricing initiatives that offset rising raw material costs drove the increase in sales.

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Operating income in the third quarter of 2008 improved \$1.5 million, or 46.9%. The combined effect of a more profitable sales mix, cost-down initiatives in operations and various margin improvement initiatives to restore profitability at low margin accounts offset lower demand year over year.

**Performance Products and Solutions**

Sales in the third quarter of 2008 were flat compared to the third quarter of 2007. Price increases necessary to offset rising raw material and higher energy costs offset a 15% decline in volume driven by the continued downturn in the North American residential building and construction market and generally softening demand in all end markets resulting from the broader downturn in the U.S. economy.

Operating income declined \$7.3 million, or 57.9%, in the third quarter of 2008 versus the third quarter of 2007 as a result of the market dynamics described above and due to margin compression driven by rising raw material costs only partially being offset by higher pricing.

**PolyOne Distribution**

PolyOne Distribution sales grew \$28.9 million, or 15.6%, in the third quarter of 2008 as compared to the third quarter of 2007. The combined impact of rising prices, continued growth in end markets, such as healthcare and consumer products, and the success of a national accounts program offset declines in building and construction and automotive end market. Sales gains were also realized due to supplier consolidation programs. Volume was down 1% in the third quarter of 2008.

Operating income increased \$4.1 million, or 77.4%, in the third quarter of 2008 versus the third quarter of 2007, driven by a more profitable sales mix of engineering resin products and operational excellence programs to mitigate rising transportation and distribution costs, as well as the cumulative impact of various margin improvement programs to improve the profitability of low margin accounts.

**Resin and Intermediates**

Operating income declined \$1.6 million, or 14.3%, in the third quarter of 2008 as compared to the third quarter of 2007. SunBelt earnings were \$2.4 million lower in the third quarter of 2008 due to a 28% decline in demand for chlorine and caustic soda, offset by higher caustic prices. Chlorine demand continued to be lower as a result of weak downstream PVC resin market conditions primarily attributable to the continued downturn in the North American residential and construction market. In the third quarter of 2008, the combined effect of Hurricanes Gustav and Ike and the subsequent temporary shutdown and declaration of force majeure by Sunbelt negatively impacted Sunbelt's shipments of chlorine and caustic soda.



**Table of Contents****Sales and Operating Income (Loss) Nine Months Ended September 30, 2008 compared with Nine Months Ended September 30, 2007:**

| (Dollars in millions)                                    | Nine Months Ended<br>September 30, |            | Change           | %<br>Change |
|--|------------------------------------|------------|------------------|-------------|
|  | 2008                               | 2007       |                  |             |
| <b>Sales:</b>  |                                    |            |                  |             |
| International Color and Engineered Materials             | \$ 491.0                           | \$ 441.7   | \$ 49.3          | 11.2%       |
| Specialty Engineered Materials                           | 197.9                              | 95.6       | 102.3            | 107.0%      |
| Specialty Color, Additives and Inks                      | 179.3                              | 179.0      | 0.3              | 0.2%        |
| Performance Products and Solutions                       | 807.4                              | 840.7      | (33.3)           | (4.0)%      |
| PolyOne Distribution                                     | 624.0                              | 560.3      | 63.7             | 11.4%       |
| Corporate and eliminations                               | (102.7)                            | (105.9)    | 3.2              | 3.0%        |
|  | \$ 2,196.9                         | \$ 2,011.4 | \$ 185.5         | 9.2%        |
| <b>Operating income (loss):</b>                          |                                    |            |                  |             |
| International Color and Engineered Materials             | \$ 22.8                            | \$ 20.3    | \$ 2.5           | 12.3%       |
| Specialty Engineered Materials                           | 11.1                               | (1.2)      | 12.3             | NM          |
| Specialty Color, Additives and Inks                      | 11.0                               | 5.7        | 5.3              | 93.0%       |
| Performance Products and Solutions                       | 18.9                               | 53.2       | (34.3)           | (64.5)%     |
| PolyOne Distribution                                     | 21.9                               | 16.4       | 5.5              | 33.5%       |
| Resin and Intermediates                                  | 24.2                               | 27.5       | (3.3)            | (12.0)%     |
| Corporate and eliminations                               | (64.5)                             | (106.6)    | 42.1             | 39.5%       |
|  | \$ 45.4                            | \$ 15.3    | \$ 30.1          | 196.7%      |
| <b>Operating income (loss) as a percentage of sales:</b> |                                    |            |                  |             |
| International Color and Engineered Materials             | 4.6%                               | 4.6%       | 0.0%<br>points   |             |
| Specialty Engineered Materials                           | 5.6%                               | (1.3)%     | 6.9%<br>points   |             |
| Specialty Color, Additives and Inks                      | 6.1%                               | 3.2%       | 2.9%<br>points   |             |
| Performance Products and Solutions                       | 2.3%                               | 6.3%       | (4.0)%<br>points |             |
| PolyOne Distribution                                     | 3.5%                               | 2.9%       | 0.6%<br>points   |             |
| Total operating income as a percentage of sales          | 2.1%                               | 0.8%       | 1.3%<br>points   |             |

NM Not meaningful

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A summary of Corporate and eliminations included in Operating income (loss) is as follows:

| (In millions)  | <b>Nine Months Ended</b> |                   |
|--|--------------------------|-------------------|
|  | <b>September 30,</b>     |                   |
|  | <b>2008</b>              | <b>2007</b>       |
| Environmental remediation costs (a)  | \$ (14.3)                | \$ (31.9)         |
| Reimbursement to Goodrich Corporation of environmental costs related to Calvert City (b) |                          | (15.6)            |
| Impairment of OxyVinyls equity investment (c)  |                          | (15.9)            |
| Employee separation and plant phaseout (d)   | (13.1)                   | (2.2)             |
| Share-based compensation (e)   | (2.2)                    | (3.6)             |
| Recognition of inventory step-up associated with GLS acquisition (f)                     | (1.6)                    |                   |
| Settlement of legal issues and related reserves  |                          | (2.4)             |
| Impairment of intangibles and other investments  |                          | (2.5)             |
| Write-down of certain assets of and investment in equity affiliate (g)                   | (4.7)                    | (1.6)             |
| All other and eliminations   | (28.6)                   | (30.9)            |
| <b>Total Corporate and eliminations</b>  | <b>\$ (64.5)</b>         | <b>\$ (106.6)</b> |

(a) In the third quarter of 2007, our accrual for costs related to future remediation at inactive or formerly owned sites was adjusted based on a U.S. District Court's rulings on several motions in the case of Westlake Vinyls, Inc. v. Goodrich Corporation et al. and a settlement agreement entered into in connection with the case, which requires us to pay remediation costs related to the Calvert City

facility.

- (b) In the third quarter of 2007, we accrued \$15.6 million to reimburse Goodrich Corporation for remediation costs paid on its behalf and certain legal costs related to the Calvert City facility.
- (c) Our 24% equity investment in OxyVinyls was adjusted at June 30, 2007 as the carrying value was higher than the fair value and the decrease was determined to be an other than temporary decline in value.
- (d) During the third quarter of 2008, we announced the restructuring of certain manufacturing assets, primarily in North America. See Note 10, Employee Separation and Plant Phaseout, for further information.
- (e) Share-based compensation expense

recognized during the nine months ended September 30, 2007 reflected the adjustment of a long-term incentive program for the sale of OxyVinyls. In addition, the stock appreciation rights granted in 2007 and 2006 had shorter vesting periods than those granted in 2008.

- (f) Upon acquisition of GLS, GLS's inventory was initially stepped up from cost to fair value. This difference was recognized with the first turn of inventory within Corporate and eliminations.
- (g) In the third quarter of 2008 and 2007, we recorded \$2.6 million and \$1.6 million, respectively, related to our proportionate share of the write-down of certain assets by Geon Polimeros Andinos, our equity affiliate in Columbia.

Also, in the third quarter of 2008, we recorded a \$2.1 million charge related to an impairment of our investment in the equity affiliate.

**International Color and Engineered Materials**

Sales in the first nine months of 2008 increased \$49.3 million, or 11.2%, as compared to the first nine months of 2007. This increase was due mainly to the favorable impact from foreign exchange of \$52.2 million and higher pricing which offset rising raw material costs. Combined, these factors offset a 3% decline in volume. Asian sales grew by 6.2%, driven by strong sales growth in our color and additives business and the favorable impact of foreign exchange. This business continued to demonstrate a growing and improved mix of specialty applications utilizing our liquid color and additives product technologies in packaging related applications. In the first nine months of 2008, demand for our products in Asia in the electrical and electronics markets softened due to a slowing of exports to North America. In Europe, sales increased 12.6% in the first nine months of 2008 compared to the same period in 2007, due to a \$46.4 million favorable impact from foreign exchange. The favorable impact of foreign exchange offset a decline in volume in our engineered materials and colorants and additives product lines which was driven by a slowdown in demand in the automotive, packaging and construction markets.

Operating income increased \$2.5 million, or 12.3%, in the first nine months of 2008 compared to the first nine months of 2007. This increase was primarily due to the favorable impact of foreign exchange of \$2.5 million and improved margins from greater penetration of specialty applications in the packaging, wire and cable and automotive end markets. The combined impact of these dynamics offset a 3% decline in volume.

**Specialty Engineered Materials**

Sales increased \$102.3 million, or 107.0%, in the first nine months of 2008 as compared to the first nine months of 2007 primarily due to \$106.7 million of sales from GLS, which was acquired in January 2008. Sales were unfavorably impacted by the general slowdown in demand in North America, particularly in automotive related markets, the pruning of customer accounts in non-specialty applications and cost containment actions by certain customers who have in-house compounding capabilities.

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Operating income was up \$12.3 million in the first nine months of 2008 as compared to the first nine months of 2007, primarily driven by the GLS acquisition and an improved mix of specialty applications in our North American Engineered Materials business, which offset lower volume. Cost containment programs and pricing initiatives to mitigate rising raw material costs also contributed to the improvement in operating income.

**Specialty Color, Additives and Inks**

Sales in the first nine months of 2008 were slightly higher versus the same period in 2007 as pricing and an improved sales mix, based on more specialty applications, offset lower volumes and the pruning of lower margin business. Slowing demand in end markets related to automotive, packaging and general industrial applications resulted in a 8% decline in volumes.

Operating income increased \$5.3 million, or 93.0%, in the first nine months of 2008 compared to the first nine months of 2007 due to a higher margin sales mix, the pruning of unprofitable business, targeted pricing actions to improve lower margin customer accounts and operational excellence initiatives to lower conversion costs.

**Performance Products and Solutions**

Sales declined \$33.3 million, or 4.0%, in the first nine months of 2008 as compared to the same period in 2007. Price increases did not fully offset rising raw material costs and volume declined 17% primarily due to the continued downturn in demand in the North American residential building and construction and automotive markets.

Operating income for the first nine months of 2008 decreased \$34.3 million, or 64.5%, as compared to the comparable period in 2007. This decrease was primarily due to the impact of the continued downturn in demand in the North American residential building and construction and automotive markets, and margin compression from higher raw material and energy costs that were not offset by price increases.

**PolyOne Distribution**

Sales grew \$63.7 million, or 11.4%, in the first nine months of 2008 compared to the first nine months of 2007.

Demand growth in health care and consumer product markets coupled with the benefits from our national accounts program to capture new customer accounts offset a decline in demand in automotive and building and construction end markets. Volume was essentially flat year over year.

Operating income improved \$5.5 million, or 33.5%, in the first nine months of 2008 versus the first nine months of 2007. This increase in profitability was due to pricing initiatives that offset rising raw material and fuel costs, improved profitability of low margin customer accounts and various operational excellence initiatives that contained operating costs.

**Resin and Intermediates**

Operating income for the nine months ended September 30, 2008 decreased \$3.3 million, or 12.0%, compared to the same period in 2007. In July 2007, we divested our 24% interest in OxyVinyls, which recorded earnings of \$0.9 million for the first nine months of 2007. Also in the third quarter of 2008, the combined effect of Hurricanes Gustav and Ike and the resulting declaration of force majeure by OxyVinyls also negatively impacted Sunbelt's shipments of chlorine and caustic soda.

SunBelt earnings were \$3.8 million, or 12.4%, lower in the first nine months of 2008 compared to the first nine months of 2007 as chlorine and caustic soda demand declined due to continued weakness in downstream PVC resin market conditions primarily attributable to the downturn in North American residential building and construction markets. Caustic pricing was 40% higher in the first nine months of 2008 versus the comparable period in 2007, only partially offsetting the negative impact on earnings of lower chlorine demand and pricing.

**Table of Contents****Liquidity and Capital Resources**

The following discussion focuses on material components of cash flows from operating, investing and financing activities from the end of the preceding fiscal year (December 31, 2007) to the date of the most recent interim balance sheet (September 30, 2008).

**Operating Activities** Our operations provided \$17.0 million of cash in the first nine months of 2008, a decrease of \$26.4 million from the same period in 2007, due primarily to a higher investment in working capital of \$75.5 million versus 2007, driven by higher selling prices and increased inventory levels, only partially offset by increases in accounts payable.

**Investing activities** Cash used by investing activities in the first nine months of 2008 was \$180.9 million, a \$398.9 million increase over the comparable period in 2007, due mainly to the purchase of GLS in January 2008. Included in the \$29.6 million of capital expenditures is \$4.5 million related to the upgrading of our enterprise resource planning system. The majority of the remainder of the expenditures was for upgrading and maintaining the capabilities of our manufacturing assets. Strategic and maintenance type projects accounted for more than 85% of the total spending.

**Financing activities** Cash provided by financing activities in the first nine months of 2008 totaled \$122.1 million, mainly the result of additional short- and long-term debt issued to fund the GLS acquisition.

As of September 30, 2008, we had existing facilities to access available capital resources (receivables sale facility, uncommitted short-term credit lines and senior unsecured notes and debentures) totaling \$627.2 million. As of September 30, 2008, we had used \$494.0 million of these facilities and \$133.2 million was available to be drawn. The following table summarizes our available and outstanding facilities at September 30, 2008:

| (In millions)                                | <b>Outstanding</b> | <b>Available</b> |
|--|--------------------|------------------|
| Long-term debt, including current maturities | \$ 390.9           | \$               |
| Receivables sale facility                    | 25.8               | 133.2            |
| Short-term debt                              | 77.3               |                  |
|  | \$ 494.0           | \$ 133.2         |

**Short-term debt** On January 3, 2008, we entered into a credit agreement with Citicorp USA, Inc., as administrative agent and as issuing bank, and The Bank of New York, as paying agent. The credit agreement provides for an unsecured revolving and letter of credit facility with total commitments of up to \$40.0 million. The credit agreement expires on March 20, 2011. Borrowings under the revolving credit facility are based on the applicable LIBOR rate plus a fixed fee. On January 9, 2008, we borrowed \$40.0 million under the agreement, which is included in short-term bank debt on the Condensed Consolidated Balance Sheet at September 30, 2008. On January 9, 2008, we entered into a floating to fixed interest rate swap expiring on January 9, 2009, resulting in an effective interest rate of 8.4%. The credit agreement contains covenants that, among other things, restrict our ability to incur liens, and various other customary provisions, including affirmative and negative covenants. As of September 30, 2008, we are in compliance with such covenants.

At September 30, 2008, \$37.3 million of short-term notes were issued by certain of our European subsidiaries. This short-term debt has durations of less than one year, is renewable with the consent of both parties and is prepayable. The weighted-average interest rate on total short-term borrowings was 7.2%, including the fixed rate interest rate swap discussed above, at September 30, 2008.

**Long-Term Debt** At September 30, 2008, long-term debt totaled \$390.9 million, with maturities ranging from 2008 to 2015. Current maturities of long-term debt at September 30, 2008 were \$2.9 million.

In April 2008, we sold an additional \$80.0 million in aggregate principal amount of 8.875% senior notes due 2012. Net proceeds from the offering were used to reduce the amount of receivables previously sold under the receivables sale facility.

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**Guarantee and Agreement** We entered into a definitive Guarantee and Agreement with Citicorp USA, Inc., on June 6, 2006. Under this Guarantee and Agreement, we guarantee the treasury management and banking services provided to us and our subsidiaries, such as subsidiary borrowings, interest rate swaps, foreign currency forwards, letters of credit, credit card programs and bank overdrafts. This guarantee is secured by certain of our inventories located in the United States.

**Receivables Sale Facility** The receivables sale facility was amended in June 2007 to extend the maturity to June 2012 and to, among other things, modify certain financial covenants and reduce the cost of utilizing the facility. In July 2007, the receivable sale facility was amended to include up to \$25.0 million of Canadian receivables, which increased the facility size to \$200.0 million. As of September 30, 2008, \$133.2 million was available. The maximum proceeds that we may receive are limited to 85% of the eligible domestic and Canadian accounts receivable sold. This facility also makes up to \$40.0 million available for issuing standby letters of credit as a sub-limit within the \$200.0 million facility, of which \$11.8 million was used at September 30, 2008.

The facility requires us to maintain a minimum fixed charge coverage ratio (defined as Adjusted EBITDA less capital expenditures, divided by interest expense and scheduled debt repayments for the next four quarters) of at least 1 to 1 when average excess availability under the facility is \$40.0 million or less.

Of the capital resource facilities available to us as of September 30, 2008, the portion of the receivables sale facility that was sold provided security for the transfer of ownership of these receivables. Each indenture governing our senior unsecured notes and debentures and our guarantee of the SunBelt notes allows a specific level of secured debt, above which security must be provided on each indenture and our guarantee of the SunBelt notes. The receivables sale facility and our guarantee of the SunBelt notes are not considered debt under the covenants associated with our senior unsecured notes and debentures. As of September 30, 2008, we had sold \$25.8 million of accounts receivable and had guaranteed \$60.9 million of our SunBelt equity affiliate's debt.

We expect that profitable operations in 2008 will enable us to maintain existing levels of available capital resources and meet our cash requirements. Expected sources of cash in 2008 include net income, additional borrowings under existing or new loan agreements, cash distributions from equity affiliates and proceeds from the sale of previously closed facilities and redundant assets. Expected uses of cash in 2008 include interest expense and discounts on the sale of accounts receivable, cash taxes, a contribution to a defined benefit pension plan, debt retirements upon maturity, environmental remediation at inactive and formerly owned sites and capital expenditures. Capital expenditures are currently estimated to be between \$50 and \$55 million in 2008, primarily to support strategic growth initiatives and manufacturing operations and to upgrade our ERP system.

Disruptions, uncertainty or volatility in the credit markets may adversely impact the availability of credit already arranged and the availability and cost of credit in the future. These market conditions may limit our ability to replace, in a timely manner, maturing liabilities and access the capital necessary to grow and maintain our business.

Accordingly, we may be forced to delay raising capital, issue shorter tenors than we prefer or pay unattractive interest rates, which could increase our interest expense, decrease our profitability and significantly reduce our financial flexibility. There can be no assurances that government responses to the disruptions in the financial markets will stabilize the markets or increase liquidity and the availability of credit.

Based on current projections, we believe that we should be able to continue to manage and control working capital, discretionary spending and capital expenditures and that cash provided by operating activities, along with available borrowing capacity under our receivables sale facility, should allow us to maintain adequate levels of available capital resources to fund our operations and meet debt service and minimum pension funding requirements.

**Critical Accounting Policies and Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles requires us to make estimates and assumptions about future events that affect the amounts reported in our financial statements and accompanying notes. We base our estimates on historical experience and assumptions that we believe are reasonable under the related facts and circumstances. The application of these critical accounting policies involves the exercise of judgment and use of assumptions for future uncertainties. Accordingly, actual results could differ significantly from



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these estimates. A description of these accounting policies and estimates is included in Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2007. For additional information regarding our accounting policies, see Note C, Summary of Significant Accounting Policies, to the Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2007.

**Goodwill and Other Intangible Assets with Indefinite Lives** As of September 30, 2008, we had \$332.8 million of goodwill and \$33.2 million of indefinite-lived other intangible assets that resulted from the acquisition of businesses. SFAS No. 142, Goodwill and Other Intangible Assets, requires us to perform impairment tests of our goodwill and other intangible assets with indefinite lives at least once a year, and more frequently if an event or circumstance indicates that an impairment or decline in value may have occurred. We have performed our annual impairment testing of goodwill as of July 1 in each year since the adoption of SFAS No. 142, Goodwill and Other Intangible Assets. During the third quarter of 2008, the impairment assessment of goodwill was completed. To make this goodwill impairment assessment, we compare the fair value of each of our reporting units with that reporting unit's carrying value. If the fair value of the reporting unit exceeds its carrying value, these assets are considered not to be impaired. If the carrying value of a reporting unit exceeds its fair value, an impairment loss is measured and recognized.

During the third quarter of 2008, we recorded a non-cash impairment charge of \$2.6 million related to our proportionate share of a write-down of goodwill of Geon Polimeros Andinos, an equity affiliate (owned 50%) and part of the Performance Products and Solutions operating segment. The impairment charge, included in Income from equity affiliates and minority interest on the Condensed Consolidated Statements of Operations and reflected on the line Corporate and eliminations in Note 14, Segment Information, mainly resulted from declines in current and projected operating results and cash flows of the equity affiliate. See Note 7, Investment in Equity Affiliates, for discussion of the impairment of the investment in Geon Polimeros Andinos during the third quarter of 2008.

As of September 30, 2008, no potential indicator of impairment exists, 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. Based upon this, we concluded that an interim assessment of goodwill as of September 30, 2008 was not required.

After completing our impairment testing as of July 1, 2008, we changed the timing of the annual impairment testing to be as of October 1 of each year. We adopted this change to assess the recorded values of goodwill and intangible assets not subject to amortization for potential impairment at a time more coincident with our strategic business planning process and closer to our fiscal year-end reporting date. This change has no effect on reported earnings for any period presented. See Note 3, Goodwill and Other Intangible Assets, and Note 19, Accounting Change Goodwill and Other Indefinite-Lived Intangible Assets, of the Condensed Consolidated Financial Statements for further discussion.

**CAUTIONARY NOTE ON FORWARD-LOOKING STATEMENTS**

In this quarterly report on Form 10-Q, statements that are not reported financial results or other historical information are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995.

Forward-looking statements give current expectations or forecasts of future events and are not guarantees of future performance. They are based on management's expectations that involve a number of business risks and uncertainties, any of which could cause actual results to differ materially from those expressed in or implied by the forward-looking statements. They use words such as will, anticipate, estimate, expect, project, intend, plan, believe and and terms of similar meaning in connection with any discussion of future operating or financial performance and/or sales. Factors that could cause actual results to differ materially from those implied by these forward-looking statements include, but are not limited to:

- the effect on foreign operations of currency fluctuations, tariffs, and other political, economic and regulatory risks;

- changes in polymer consumption growth rates where PolyOne conducts business;



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changes in global industry capacity or in the rate at which anticipated changes in industry capacity come online in the polyvinyl chloride (PVC), chlor alkali, vinyl chloride monomer (VCM) or other industries in which PolyOne participates;

fluctuations in raw material prices, quality and supply and in energy prices and supply;

production outages or material costs associated with scheduled or unscheduled maintenance programs;

unanticipated developments that could occur with respect to contingencies such as litigation and environmental matters, including any developments that would require any increase in our costs and/or reserves for such contingencies;

an inability to achieve or delays in achieving or achievement of less than the anticipated financial benefit from initiatives related to PolyOne's specialization strategy, operational excellence initiatives, cost reductions and employee productivity goals;

an inability to raise or sustain prices for products or services;

an inability to maintain appropriate relations with unions and employees;

the possibility that the degradation in the North American residential construction market is more severe than anticipated;

the timing of plant closings in connection with the recently announced manufacturing realignment;

separation and severance amounts that differ from original estimates because of the timing of employee terminations;

amounts for non-cash charges relating to property, plant and equipment that differ from the original estimates because of the ultimate fair market value of such property, plant and equipment;

amounts required for capital expenditures at remaining locations changing based on the level of expenditures required to shift production capacity;

PolyOne's ability to realize anticipated savings and operational benefits from its realigning of assets, including those related to closure of certain production facilities;

disruptions, uncertainty or volatility in the credit markets that may limit our access to capital; and

other factors affecting our business beyond our control, including, without limitation, changes in the general economy, changes in interest rates and changes in the rate of inflation.

We cannot guarantee that any forward-looking statement will be realized, although we believe we have been prudent in our plans and assumptions. Achievement of future results is subject to risks, uncertainties and inaccurate assumptions. Should known or unknown risks or uncertainties materialize, or should underlying assumptions prove inaccurate, actual results could vary materially from those anticipated, estimated or projected. Investors should bear this in mind as they consider forward-looking statements.

We undertake no obligation to publicly update forward-looking statements, whether as a result of new information, future events or otherwise, except as required by law. You are advised, however, to consult any further disclosures we make on related subjects in our reports on Forms 10-Q, 8-K and 10-K furnished to the SEC. You should understand

that it is not possible to predict or identify all risk factors. Consequently, you should not consider any such list to be a complete set of all potential risks or uncertainties.

**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

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, 2007.

**Interest rate exposure** We periodically enter into interest rate swap agreements that modify our exposure to interest rate risk by converting some of our floating-rate obligations to fixed rates. In connection with the \$40.0 million borrowed under the revolving credit facility in January 2008, PolyOne entered into a \$40.0 million floating to fixed interest rate swap expiring on January 9, 2009, resulting in an effective interest rate of 8.4%. This derivative is not treated as a hedge and, as a result, is marked to market, with the resulting gain and loss recognized as interest expense in the Condensed Consolidated Statements of Operations. At September 30, 2008, this agreement had a fair value obligation of less than \$0.1 million.

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**Foreign currency exposure** We enter into foreign currency exchange forward contracts with major financial institutions to reduce the effect of fluctuating exchange rates, primarily on foreign currency intercompany lending transactions. These contracts are not treated as hedges and, as a result, are market to market, with the resulting gains and losses recognized as other income or expense in the Condensed Consolidated Statements of Operations. Realized gains and losses on these contracts offset the foreign exchange gains and losses on the underlying transactions. At September 30, 2008, these agreements had a fair value of \$1.1 million.

There have been no material changes in the market risk faced by PolyOne from December 31, 2007 to September 30, 2008.

**Item 4. Controls and Procedures**

**Disclosure controls and procedures**

PolyOne's management, under the supervision of and with the participation of its Chief Executive Officer and its Chief Financial Officer, has evaluated the effectiveness of the design and operation of PolyOne's disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as of the end of the period covered by this quarterly report. Based upon this evaluation, PolyOne's Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of the period covered by this quarterly report, its disclosure controls and procedures were effective.

**Table of Contents****Changes in internal control over financial reporting**

There were no changes in PolyOne's internal control over financial reporting during the quarter ended September 30, 2008 that have materially affected, or are reasonably likely to materially affect, its internal control over financial reporting. During the quarter ended September 30, 2008, the Company upgraded its SAP enterprise resource planning system to the most current version of the new software 6.0. This upgrade was completed successfully and according to plan on August 18, 2008 with no material effect on internal control over financial reporting.

**Part II Other Information****Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

The table below sets forth information regarding repurchases by the Company of its common shares during the period indicated:

| <b>Period</b>               | <b>Total Number of Shares Purchased</b> | <b>Average Price Paid Per Share</b> | <b>Total Number of Shares Purchased as Part of Publicly Announced Program</b> | <b>Maximum Number of Shares that May Yet be Purchased Under the Program (1)</b> |
|-----------------------------|---|-------------------------------------|---|---|
| July 1 to July 31           |   | \$                                  |   |   |
| August 1 to August 31       | 227,300                                 | 8.08                                | 227,300   | 9,772,700   |
| September 1 to September 30 | 772,700                                 | 7.88                                | 772,700   | 9,000,000   |
| <b>Total</b>                | <b>1,000,000</b>                        | <b>\$ 7.93</b>                      | <b>1,000,000</b>  |   |

(1) On August 18, 2008, our Board of Directors approved a stock repurchase program authorizing the Company, depending upon market conditions and other factors, to repurchase up to 10.0 million shares of its common stock, in the open market or in privately negotiated transactions.

**Item 6. Exhibits****Exhibit No. Description of Exhibit**

|       |   |
|-------|---|
| 10.1+ | Amended and Restated Letter Agreement, dated as of July 16, 2008, between the Company and Stephen D. Newlin, originally effective as of February 13, 2006   |
| 10.2+ | Consulting Agreement between the Company and W. David Wilson, dated September 9, 2008   |
| 18.1  | Letter regarding Change in Accounting Principles  |
| 31.1  | Certification of Stephen D. Newlin, Chairman, President and Chief Executive Officer, pursuant to SEC Rules 13a-14(a) and 15d-14(a), adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002     |
| 31.2  | Certification of Robert M. Patterson, Senior Vice President and Chief Financial Officer, pursuant to SEC Rules 13a-14(a) and 15d-14(a), adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |

32.1 Certification of Stephen D. Newlin, Chairman, President and Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

32.2 Certification of Robert M. Patterson, Senior Vice President and Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

+ Indicates management contract or compensatory plan, contract or arrangement in which one or more directors or executive officers of the Registrant may be participants

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SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

November 5, 2008

POLYONE CORPORATION

/s/ Robert M. Patterson

Robert M. Patterson  
Senior Vice President and Chief Financial  
Officer  
(Principal Financial Officer and Principal  
Accounting Officer)

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