[Table of Contents]

# United States
# Securities and Exchange Commission

Washington, D.C. 20549

## FORM 10-K

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

For the fiscal year ended December 31, 2005

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

For the transition period from to .

Commission file number 1-16091

# PolyOne Corporation

(Exact name of registrant as specified in its charter)

| OHIO<br>(State or other jurisdiction of<br>incorporation or organization) | 34-1730488<br>(IRS Employer Identification No.) |
|---|---|
| 33587 Walker Road,<br>Avon Lake, Ohio<br>(Address of principal executive offices) | 44012<br>(Zip Code) |

Registrant's telephone number, including area code (440) 930-1000

Securities registered pursuant to Section 12(b) of the Act:

| Title of each class | **Name of each exchange on which registered** |
|---|---|
| Common Stock, par value $.01 per share | New York Stock Exchange |

Securities registered pursuant to Section 12(g) of the Act:
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No ☑

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No ☑

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 o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☑

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

Large accelerated filer o Accelerated filer ☑ Non-accelerated filer o

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

The aggregate market value of the registrant's outstanding voting common stock held by non-affiliates on June 30, 2005, determined using a per share closing price on that date of $6.62, as quoted on the New York Stock Exchange, was $469,571,000.

The number of shares of common stock outstanding as of March 13, 2006 was 92,204,460.

DOCUMENTS INCORPORATED BY REFERENCE

Part III of this Annual Report on Form 10-K incorporates by reference certain information from the registrant's definitive Proxy Statement to be filed on or about March 30, 2006 with respect to the 2006 Annual Meeting of Shareholders.

**TABLE OF CONTENTS**

PART I
- ITEM 1. BUSINESS
- ITEM 1A. RISK FACTORS
- ITEM 1B. UNRESOLVED STAFF COMMENTS
- ITEM 2. PROPERTIES
- ITEM 3. LEGAL PROCEEDINGS
- ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS
- PART II
- ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES
- ITEM 6. SELECTED FINANCIAL DATA
- ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS
- ITEM 7A. QUANTITATIVE AND QUALITATIVE INFORMATION ABOUT MARKET RISK
- ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

MANAGEMENT'S REPORT
REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM
REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM
- ITEM 9. CHANGES IN AND DISAGREEMENTS WITHACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE
- ITEM 9A. CONTROLS AND PROCEDURES
- ITEM 9B. OTHER INFORMATION
- PART III
- ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT
- ITEM 11. EXECUTIVE COMPENSATION
- ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED SHAREHOLDER MATTERS
- ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS
- ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES
- PART IV
- ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

Exhibit 10.11(B) Schedule of Executives w/ Management
Exhibit 10.25 Stock Purchase Agreement
Exhibit 21.1 Subsidiaries of the Company
Exhibit 23.1 Consent (Ernst & Young LLP)
Exhibit 23.2 Consent (KPMG LLP)
Exhibit 23.3 Consent (Ernst & Young LLP)
Exhibit 31.1 Cert of the CEO
Exhibit 31.2 Cert of the CFO
Exhibit 32.1 Cert of the CEO Section 906 and 1350
Exhibit 32.2 Cert of the CFO Section 906 and 1350
Exhibit 99.1 Audited Financial Stements Oxy Vinyls LP
Exhibit 99.2 Audited Financials Statements of Sunbelt Chlor

**PART I**

## ITEM 1. BUSINESS

### Business Overview

PolyOne Corporation is a leading global compounding and North American distribution company with operations in thermoplastic compounds, specialty polyvinyl chloride (PVC) vinyl resins, specialty polymer formulations, color and additive systems, and thermoplastic resin distribution, with equity investments in manufacturers of PVC resin and its intermediates. When used in this report, the terms "we," "us," "our" and the "Company" mean PolyOne Corporation and its subsidiaries.

We are incorporated in Ohio and our headquarters are in Avon Lake, Ohio. We employ approximately 4,500 people and have 53 manufacturing sites and 14 warehouses in North America, Europe and Asia, with joint ventures in North America and Colombia. We sell more than 35,000 different specialty and commodity products to over 10,000 customers in 35 countries. In 2005, we had sales of $2.5 billion, 21% of which were from customers outside North 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 processes to provide an essential link between large chemical producers (our raw material suppliers) and designers, assemblers and processors of plastics (our customers). We believe that: large chemical producers are increasingly outsourcing less-than-railcar business; polymer and additive producers need multiple channels to market; processors continue to outsource compounding; and international companies need suppliers with global reach. Our goal is to provide our customers with global reach and product platforms, low-cost manufacturing operations, a fully integrated information technology network, broad market knowledge and raw material procurement leverage. Our end markets are primarily in the automotive, building materials, durable goods, packaging, business equipment and telecommunications markets, as well as many industrial applications.

PolyOne was formed on August 31, 2000 from the consolidation of The Geon Company (Geon) and M.A. Hanna (Hanna). Geon's roots go back to 1927 when BFGoodrich scientist Waldo Semon produced the first usable vinyl polymer. In 1948, BFGoodrich created a vinyl plastic division that was subsequently spun off through a public offering in 1993, creating Geon, a separate publicly held company. Hanna was formed in 1885 as a privately held company and became publicly held in 1927. In the mid-1980s, Hanna began to shed its historic mining and shipping businesses to focus on polymers. Hanna purchased its first polymer company in 1986 and completed its 26th polymer company acquisition by 2000.

### Recent Developments

***Sale of businesses and discontinued operations***

As of December 31, 2004, our Engineered Films and Specialty Resins businesses qualified for accounting treatment as discontinued operations.

In September 2005, we announced that we had signed a letter of intent to sell our Engineered Films business. On February 15, 2006, we sold 82% of the Engineered Films business, retaining an 18% ownership interest. All historical financial information for the Engineered Films business has been accounted for as a discontinued operation.

In December 2005, we announced that the Specialty Resins divestment process was unlikely to result in a sale of the business at acceptable terms. As a result, its financial results have been reclassified from discontinued operations to continuing operations for all historic periods presented as of December 31, 2005. It is now included in the Performance Plastics segment, where it had been previously.

Unless otherwise noted, disclosures contained in this report relate to continuing operations. For more information about our discontinued operations, see Note B to the Consolidated Financial Statements.

***Purchase of businesses***

In January 2005, we completed the purchase of the remaining 16% of equity ownership in Star Color, a color additives manufacturing subsidiary in Thailand, for $1.6 million. This business is included in the Performance Plastics segment.

In May 2005, we purchased equipment, compounding recipes and a customer list from Novatec Plastics Corporation, a compounding business owned by PVC Container Corporation, for $1.1 million. These assets are included in the Performance Plastics segment and are used to serve our customers in the custom profile and custom molding markets.

***Executive management changes***

In October 2005, Thomas A. Waltermire resigned as our president and chief executive officer, and as a director. William F. Patient, non-executive chairman of the board, served as interim chief executive officer until a permanent successor was named.

In January 2006, V. Lance Mitchell, group vice president and general manager of Color and Engineered Materials, resigned to accept a position with another company. Robert Bindner, director of sales for Color and Additives, is filling this position until a permanent successor is selected. Mr. Bindner will continue to handle his current duties in the interim.

In February 2006, Stephen D. Newlin joined the company as chairman, president and chief executive officer. He was president of

the Industrial Sector of Ecolab, Inc. from 2003 to 2006, and prior to that was president and a director with Nalco Chemical Company from 1998 to 2001 and served as chief operating officer and vice-chairman from 2000 to 2001.

***Restructuring initiatives and facility closures***

In November 2005, we announced that we would close our Manchester, England plastic color additives facility to reduce costs and align capacity with market demand. Production is being phased out while business with key customers is either being transitioned to other PolyOne facilities or customers secure alternative sources for products. The facility had 44 employees. We expect that the process will be completed by the end of the first quarter of 2006.

**Polymer Industry Overview**

Polymers are a class of organic materials that are generally produced by converting natural gas or crude oil derivatives into monomers, such as ethylene, propylene, vinyl chloride and styrene. These monomers are then polymerized into chains called polymers, or plastic resin, in its most basic form. Large petrochemical companies, including some in the petroleum industry, produce a majority of the monomers and base resins because they have direct access to the raw materials needed for production. Monomers make up the majority of the variable cost of manufacturing the base resin. As a result, the cost of a base resin tends to move in tandem with the industry market prices for monomers and the cost of raw materials and energy used during production. Resin selling prices also tend to move in tandem with costs, and with supply and demand. Through our equity interests in Oxy Vinyls, LP (OxyVinyls) and SunBelt Chlor-Alkali Partnership (SunBelt), we realize a portion of the economic benefits of a base resin producer for PVC resin, one of our major raw materials.

Thermoplastic polymers make up a substantial majority of the resin market and are characterized by their ability to be reshaped repeatedly into new forms after heat and pressure is applied. Thermoplastics offer versatility and a wide range of applications. The major types of thermoplastics include polyethylene, polyvinyl chloride, polypropylene, polystyrene, polyester and a range of specialized engineering resins. Each type of thermoplastic has unique qualities and characteristics that make it appropriate for use in a particular product.

Thermoplastic resins are found in a number of end-use products and in a variety of markets, including packaging, building and construction, transportation, furniture and furnishings, consumer durables, institutional products, electrical, adhesives, inks and coatings. Each type of thermoplastic resin has unique characteristics (such as flexibility, strength or durability) suitable for use in a particular end-use product. The packaging industry, the largest consumer of plastics, requires plastics that help keep food fresh and free of contamination while providing a variety of options for product display, and offering advantages in terms of weight and user-friendliness. In the building and construction industry, plastic provides an economical and energy efficient replacement for other traditional materials in piping applications, siding, flooring, insulation, windows and doors, as well as structural and interior or decorative uses. In the transportation industry, plastic has proved to be durable, lightweight and corrosion resistant while offering fuel savings, design flexibility and high performance.

Various additives can be combined with a base resin to provide it with greater versatility and performance. These combinations are known as plastic compounds. Plastic compounds have advantages over metals, wood, rubber and other traditional materials, which have resulted in the replacement of these materials across a wide spectrum of applications ranging from automobile parts to construction materials. Plastic compounds offer relatively low cost, reduced weight and comparatively better performance. Plastics have a reputation for durability, aesthetics, ease of handling and recyclability. Our Performance Plastics segment, which accounts for 73% of our total sales, is primarily comprised of compounded thermoplastics. Our Distribution segment, which accounts for 27% of our total sales, is a distributor of a wide range of thermoplastic resins and compounds.

**PolyOne Segments**

We operate within three segments: Performance Plastics, Distribution, and Resin and Intermediates. For more information about our segments, see Note R to the Consolidated Financial Statements, which is incorporated by reference.

***Performance Plastics:***

Our Performance Plastics segment is an independent merchant compounder of plastics for manufacturers of plastic products throughout North America and Europe, with a growing presence in Asia. We perform proprietary compounding of thermoplastics to the performance requirements of manufacturers of molded and extruded plastic products. In addition to compounds, we also manufacture concentrates, masterbatches, liquid dispersions, dry colorants and additive masterbatches for use in compounding by our customers in the plastic industry. We also manufacture and compound dispersion-grade PVC resins and other polymers with different additives to produce liquid or solid compounds for coating systems.

For the fiscal year ended December 31, 2005, our Performance Plastics segment had sales to external customers of $1,778.7 million, operating income of $62.8 million and total assets of $1,115.6 million.

The Performance Plastics business is made up of the following product groups: Vinyl Compounds, North American Colors and Additives, North American Engineered Materials, International Colors and Engineered Materials, Polymer Coating Systems and Specialty Resins.

***Vinyl Compounds*** – Vinyl, or PVC, is a highly versatile plastic. It can be made thin and flexible enough for intravenous solution bags, yet rigid and tough enough for window frames and computer housings. Because of this versatility, vinyl is one of the most widely used plastics, utilized in a wide range of applications. Our vinyl compounds combine PVC resins with a broad range of additives that provide product versatility, particularly when fire resistance, chemical resistance or weatherability is required. We believe that we are the leading manufacturer of vinyl compounds in North America. In 2005, Vinyl Compounds accounted for 40% of our Performance Plastics segment's sales.

***North American Colors and Additives*** – Color and additive concentrates, or masterbatches, are plastic compounds that contain a high concentration of color pigments or additives that are dispersed in a polymer carrier medium and are sold in pellet, liquid, flake or powder form. Color masterbatches are used with the base resin mix so that the correct color or additive performance is achieved. Additive masterbatches include a wide variety of products, and are commonly categorized by the function they perform, such as UV stabilizers, slip/antiblock, antistat, blowing agents, antioxidants, lubricants and stabilizers.

Our color and additive masterbatches provide flexibility to plastic processors who prefer to create multiple color effects or enhance the performance of their own base polymers. Our colors and additives for thermoplastics are used throughout the plastics industry, particularly in the outdoor decking, packaging, automotive, consumer, pipe, and wire and cable industries. They are also incorporated into such end-use products as stadium seating, toys, housewares, vinyl siding, pipe, food packaging and medical packaging. In 2005, North American Colors and Additives accounted for 13% of our Performance Plastics segment's sales.

***North American Engineered Materials*** – Our engineered materials consist of reinforced and filled plastic compounds and thermoplastic elastomer compounds. With our compounding expertise, we have the ability to expand the performance range and structural properties of traditional engineering-grade thermoplastic resins. We combine our knowledge of base polymers, lubricants, fillers, reinforcements and a wide range of functional additives to tailor our compounds to meet customers' unique application requirements.

Our compounds incorporate commodity resins such as polyethylene and polypropylene, and engineering resins such as nylon, polycarbonate and polyesters. We also have a broad product line of thermoplastic elastomer compounds, including thermoplastic olefins, thermoplastic vulcanizates and styrene block copolymers. In 2005, North American Engineered Materials accounted for 6% of our Performance Plastics segment's sales.

***International Colors and Engineered Materials*** – Colors, additive masterbatches and engineered materials that are manufactured and sold throughout Europe and Asia accounted for 25% of our Performance Plastics segment's sales during 2005.

***Polymer Coating Systems (formerly known as Formulators)*** – Polymer Coating Systems products consist primarily of liquid systems with a base resin of specialty vinyl resin, natural rubber latex or polyurethane resin. Products also include proprietary PVC screen printing inks and powders, latex, specialty additives and colorants that meet the specific needs of customers' applications. Applications include: inks for textiles in the consumer industry; armrests, headrests and oil filters in the automotive industry; coil coatings, sheet vinyl and carpet backing in the construction industry; and decals, coatings and tool handles for general industry. In 2005, Polymer Coating Systems accounted for 9% of our Performance Plastics segment's sales.

***Specialty Resins*** – Specialty vinyl resins are usually compounded in a liquid form for flexible product applications and are largely customized to specific end-use applications. Our specialty vinyl resins are used in products such as vinyl flooring, carpeting, automotive instrument and door panels, coated fabrics, medical examination gloves and foam products. Approximately 13% of our specialty vinyl resins are used in our Polymer Coating Systems products as one of the primary raw materials. In 2005, Specialty Resins accounted for 7% of our Performance Plastics segment's sales.

***Distribution:***

We distribute more than 3,500 grades of engineering and commodity grade resins and compounds, including PolyOne-produced products, to the North American market. We purchase bulk quantities of base plastic resins, such as polycarbonate, polyethylene, polypropylene and polystyrene from approximately 20 major suppliers and resell them in truckload and less-than-truckload quantities to more than 5,000 customers throughout North America. These products are sold to custom molders and extruders who, in turn, convert them into plastic products that are sold to a number of different industries and end-use markets. In 2005, we sold approximately 640 million pounds of product from more than 30 stocking locations, including ten repackaging plants, across North America.

For the fiscal year ended December 31, 2005, our Distribution segment had sales to external customers of $671.9 million, operating income of $19.5 million and total assets of $176.9 million.

***Resin and Intermediates:***

We report the results of our Resin and Intermediates segment on the equity method. This segment consists almost entirely of our 24% equity interest in OxyVinyls and our 50% equity interest in SunBelt. OxyVinyls is a partnership with Occidental Chemical Corporation, and SunBelt is a partnership with Olin Corporation. OxyVinyls is North America's second largest and the world's third largest producer of PVC resin. In 2005, OxyVinyls had production

capacity of approximately 4.3 billion pounds of PVC resin, 6.2 billion pounds of vinyl chloride monomer (VCM), which is an intermediate chemical in the production of PVC, 580 thousand tons of chlorine and 667 thousand tons of caustic soda. The 6.2 billion pounds of vinyl chloride monomer capacity includes approximately 2.4 billion pounds owned by OxyMar, a partnership that is 50% owned by OxyVinyls. In 2005, SunBelt had production capacity of approximately 290 thousand tons of chlorine and 320 thousand tons of caustic soda. Most of the chlorine manufactured by OxyVinyls and SunBelt is consumed by OxyVinyls to produce PVC resin. Caustic soda is sold on the merchant market to customers in the pulp and paper, chemical, construction and consumer products industries.

In addition to providing us with a secure and high-quality supply of PVC resin, our Resin and Intermediates segment provides us with backward integration through our ownership position and contractual arrangements. First, our purchases of PVC resin and VCM from OxyVinyls are at competitive prices based on long-term supply contracts. The PVC resin is used to make our vinyl compounds, and the VCM is used to make our specialty resins. Second, our equity investment in OxyVinyls provides a hedge against a portion of raw material price increases to the extent that OxyVinyls can pass on increased raw material costs to its other customers. Finally, our equity position in chlorine and caustic soda through OxyVinyls and SunBelt provides economic integration to the chlorine chain.

For the fiscal year ended December 31, 2005, our Resin and Intermediates segment had operating income of $67.1 million, which included a $22.9 million non-cash impairment charge related to a previously idled chlor-alkali facility at OxyVinyls. We also received $67.4 million of cash from dividends, distributions and returns on capital from all of our Resin and Intermediates segment equity affiliates.

**Competition**

The production of compounded plastics and the manufacture of custom and proprietary formulated color and additives systems for the plastics industry is highly competitive. Competition is based on price, delivery, service, performance, product innovation, product recognition and quality. The relative importance of these factors varies among our products and services. We believe that we are the largest independent compounder of plastics and producer of custom and proprietary formulated color and additive masterbatch systems in the United States and Europe, with a growing presence in Asia. Our competitors range from large international companies with broad product offerings to small independent custom compounders whose focus is a specific market niche.

The distribution of polymer resin is also highly competitive. Price, delivery, service, product recognition and quality are the principal factors affecting competition. In less-than-truckload thermoplastic resin and compound distribution, we believe that we are the second largest independent thermoplastic resin distributor in North America. We compete against Ashland Distribution, a division of Ashland Inc., the largest independent resin distributor in North America, along with other smaller regional distributors. Growth in the thermoplastic resin and compound distribution market correlates directly with growth in the market for base polymer resins.

We believe that the strength of our company name and reputation, the broad range of product offerings from our suppliers and our speed and responsiveness, coupled with the quality of products and flexibility of our distribution network, allow us to compete effectively.

**Raw Materials**

The primary raw materials used by our Performance Plastics segment are PVC resin, VCM, polyolefin and other thermoplastic resins, plasticizers, inorganic and organic pigments, all of which are in adequate supply. Hurricane-related raw material shortages and supply allocations that occurred in the second half of 2005 impacted our ability to obtain raw materials. Many of our suppliers declared force majeure, causing us to also declare force majeure. However, raw material availability issues were substantially resolved by the end of the year. We have long-term supply contracts with OxyVinyls, under which the majority of our PVC resin and all of our VCM is supplied. These contracts will expire in 2013, although they contain two five-year renewal provisions that are at our option. We believe these contracts should assure the availability of adequate amounts of PVC resin and VCM. We also believe that the pricing under these contracts provides PVC resins and VCM to us at a competitive cost.

**Patents and Trademarks**

We own and maintain a large number of U.S. and foreign patents and trademarks, which are important because they protect our inventions and product names against infringement by others and, as a result, enhance our position in the marketplace. Patents vary in duration up to 20 years, and trademarks have an indefinite life based upon continued use. While we view our patents and trademarks to be valuable, because of the broad scope of our products and services, we do not believe that the loss or expiration of any single patent or trademark would have a material adverse effect on our results of operations, financial position or the continuation of our business.

**Seasonality and Backlog**

Sales of our products and services tend not to be seasonal, though demand is generally slower in the first and fourth calendar quarters of the year. Because of the nature of our business, we do not believe our backlog is a meaningful indicator of the level of our present or future business.

**Working Capital Practices**

We, along with other companies in our industry, are generally not subject to unusual working capital practices. The nature of our business does not require us to carry significant amounts of inventories to meet rapid delivery requirements of our products or services or assure ourselves of a continuous allotment of goods from suppliers. Our manufacturing processes are generally performed with a short turnaround time, and the scheduling of manufacturing activities from customer orders generally includes enough lead time to assure delivery of adequate supply of raw materials. We do not generally offer extended payment terms to our customers. We generally allow our customers to return merchandise for failure to meet pre-agreed quality standards or specifications; however, we employ quality assurance practices that seek to minimize customer returns.

**Significant Customers**

None of our customers accounts for more than two percent of our consolidated revenues, and none of our segments is dependent upon a single customer, or a few customers, the loss of which would have a material adverse effect on the segment.

**Research and Development**

We have substantial research and development capabilities. Our efforts are largely devoted to developing new product formulations to satisfy defined market needs, providing quality technical services to evaluate alternative raw materials, assuring the continued success of our products for customer applications, providing technology to improve our products, processes and applications, and providing support to our manufacturing plants for cost reduction, productivity and quality improvement programs. We operate research and development centers that support our manufacturing operations. These facilities are equipped with state-of-the-art analytical, synthesis, polymer characterization and testing equipment, along with pilot plants and polymer compounding operations that simulate specific production processes to rapidly translate new technologies into new products.

Our investment in product research and development totaled $16.9 million in 2005, $15.6 million in 2004 and $18.5 million in 2003. In 2006, we expect our product research and development investment to be consistent with prior years' levels.

**Methods of Distribution**

Our Performance Plastics and Distribution segments sell products primarily through direct sales personnel. The Performance Plastics segment supplements direct sales personnel with distributors, including our Distribution segment, and commissioned sales agents for other various products and geographic areas. We primarily use truck carriers to transport our products to customers, although some customers pick up product at our operating facilities or warehouses for each of these segments. In addition, we ship some Performance Plastics products to customers by railroad cars.

**Employees**

As of February 17, 2006, we employed approximately 4,500 people. Sixty persons were represented by labor unions under collective bargaining agreements that expire from December 31, 2006 to May 31, 2008, and another 120 persons are currently in negotiations to enter into a collective bargaining agreement. We believe that relations with our employees are good and we do not anticipate significant problems in current negotiations or in renegotiating our collective bargaining agreements as they expire.

**Environmental, Health and Safety**

We are subject to various environmental laws and regulations to protect the environment. These laws apply to the production, use and sale of chemicals, emissions into the air, discharges into waterways and other releases of materials into the environment, and the generation, handling, storage, transportation, treatment and disposal of waste material. We endeavor to ensure the safe and lawful operation of our facilities in the manufacture and distribution of products, and we believe we are in material compliance with all applicable laws and regulations.

We maintain a disciplined environmental and occupational safety and health compliance program and conduct periodic internal and external regulatory audits at our facilities to identify and categorize potential environmental exposures, including compliance issues and the actions required to address them. This effort can result in process or operational modifications, the installation of pollution control devices or cleaning up grounds or facilities. We believe that we are in material compliance with all applicable requirements. We incurred environmental expense of $0.2 million in 2005, $10.3 million in 2004 and $4.1 million in 2003. Environmental expense is presented net of insurance recoveries of $2.2 million in 2005, $1.8 million in 2004 and $0.1 million in 2003. We expect future environmental remediation expense will be approximately $3 million to $5 million per year.

With respect to safety, our injury incidence rate was 1.4 in 2005, down from 1.9 in 2004. The average injury incidence rate for our SIC Code (30 Rubber and Miscellaneous Plastic Products) is 8.5. The U.S. Department of Labor defines the incidence rate as the number of injuries per 100 full-time workers per year.

We believe that compliance with all current governmental regulations will not have a material adverse effect on our results of operations or financial condition. The risk of additional costs and liabilities, however, is inherent in certain plant operations and certain products produced at these plants, as is the case with other companies in the plastics industry. Therefore, we may incur additional costs or liabilities in the future. Other developments, such as increasingly strict environmental, safety and health laws, regulations

and related enforcement policies, discovery of unknown conditions, and claims for damages to property, persons or natural resources resulting from plant emissions or products could also result in additional costs or liabilities.

A number of foreign countries and domestic communities have enacted, or are considering enacting, laws and regulations concerning the use and disposal of plastic materials. Widespread adoption of these laws and regulations, along with public perception, may have an adverse impact on plastic materials. Although many of our major markets are in durable, longer-life applications that could reduce the impact of these kinds of environmental regulations, more stringent regulation of the use and disposal of plastics may have an adverse effect on our business.

We have been notified by federal and state environmental agencies and by private parties that we may be a potentially responsible party (PRP) in connection with the investigation and remediation of a number of environmental waste disposal sites. While government agencies assert that PRPs are jointly and severally liable at these sites, in our experience, interim and final allocations of liability costs are generally made based on the relative contribution of waste. However, even when allocations of costs based on relative contribution of waste have been made, we cannot assure that our allocation will not be increased due to the failure of other PRPs to pay their allocated share of these costs.

We also conduct investigations and remediation at several of our active and inactive facilities and have assumed responsibility for the resulting environmental liabilities from operations at sites formerly owned or operated by us or our predecessors. We believe that our potential continuing liability at these sites will not have a material adverse effect on our results of operations or financial position. In addition, we voluntarily initiate corrective and preventive environmental projects at our facilities. Based on current information and estimates prepared by our environmental engineers and consultants, we had reserves on our December 31, 2005 Consolidated Balance Sheet totaling $55.2 million to cover probable future environmental expenditures related to previously contaminated sites. This figure represents management's best estimate of costs for probable remediation, based upon the information and technology currently available and management'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 we could incur additional costs in excess of the amount accrued at December 31, 2005. Such costs, if any, cannot be currently estimated. Our estimate of the liability may be revised as new regulations or technologies are developed or additional information is obtained.

**International Operations**

Our international operations are subject to a variety of risks, including currency fluctuations and devaluations, exchange controls, currency restrictions and changes in local economic conditions. While the impact of these risks is difficult to predict, any one or more of them could adversely affect our future operations. For more information about our international operations, see Note R to the Consolidated Financial Statements, which is incorporated by reference.

**Available Information**

Our Internet address is www.polyone.com. Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 are available, free of charge on our website or upon written request, as soon as reasonably practicable after we electronically file or furnish them to the Securities and Exchange Commission (SEC). These reports are also available on the SEC's website at www.sec.gov.

## ITEM 1A. RISK FACTORS

The following are certain risk factors that could affect our business, results of operations and financial condition. These risk factors should be considered in connection with evaluating the forward-looking statements contained in this Annual Report on Form 10-K because these factors could cause our actual results or financial condition to differ materially from those projected in forward-looking statements. Before you invest in us, you should know that making such an investment involves some risks, including the risks we describe below. The risks that are discussed below are not the only ones we face. If any of the following risks occur, our business, results of operations or financial condition could be negatively affected.

***Demand for and supply of our products and services may be adversely affected by several factors, some of which we cannot predict or control, that could adversely affect our results of operations.***

Several factors may affect the demand for and supply of our products and services, including:

- end of application life-cycle, model change-over or obsolescence issues due to more cost effective alternative materials;
- changes in the market acceptance of our products and services;
- competition from other polymer and chemical companies;
- declines in the general level of industrial production;
- declines in general economic conditions;

- changes in world or regional plastic or PVC consumption growth rates;
- changes in capacity in the PVC, VCM or chlor-alkali industries;
- changes in environmental regulations that would limit our ability to sell our products and services in specific markets; and
- inability to obtain raw materials due to factors such as weather, supplier work stoppages, or plant outages.

If any of these factors occur, the demand for and supply of our products and services could suffer, which would adversely affect our results of operations.

***Increased raw material and energy costs could reduce our income.***

The primary raw material in our Performance Plastics business segment is PVC resin. The majority of our PVC resin is purchased from our Resin and Intermediates segment equity affiliate, OxyVinyls, under a long-term supply contract. However, the price of PVC resin fluctuates under this contract in tandem with the industry market prices for PVC resin and the prices of raw materials (primarily ethylene, chlorine and natural gas) that are used to manufacture PVC resin. In 2005, the price of natural gas rose significantly and the available supply of raw materials was adversely impacted to a lesser degree primarily due to Hurricanes Rita and Katrina. Any increases in the costs of energy will increase our production costs and those of our suppliers. Although we attempt to pass on higher raw material and energy costs to our customers, given our competitive markets, it is often not possible to pass on all of these increased costs in a timely manner.

***Our sales and operating results are sensitive to global economic conditions and cyclicality, and could be adversely affected during economic downturns.***

General economic conditions and business conditions of our customers' industries affect demand for our products. The business of most of our customers, particularly our industrial, automotive, construction and electronics customers, are cyclical to varying degrees and have historically experienced periodic downturns. Political instability, particularly in the Middle East, may lead to financial and economic instability, which could lead to deterioration in general global economic conditions. A downturn in economic conditions could adversely affect the demand for our products and services, which could adversely affect our sales and operating results. In addition, downturns in our customers' industries, even during periods of strong general economic conditions, could adversely affect our sales and operating results.

***Our participation in joint ventures may adversely affect our results of operations.***

We participate in joint ventures both in the United States and Colombia. In some joint ventures, such as SunBelt, we are equal partners with another corporation, while in others, such as OxyVinyls, we hold a minority interest. We may enter into additional joint ventures in the future. The nature of a joint venture requires us to share control with unaffiliated third parties. If our joint venture partners do not fulfill their obligations, the joint venture may not be able to operate according to its business plan. In that case, our results of operations may be adversely affected or we may be required to increase our level of commitment to the joint venture. Also, differences in views among joint venture participants may result in delayed decisions, or failures to agree on major issues could have an adverse effect on our business, results of operations or financial condition.

OxyVinyls and SunBelt are our two largest equity investments. OxyVinyls manufactures PVC resins and chlor-alkali, and SunBelt manufactures chlor-alkali. The earnings of each of these partnerships may be significantly affected by changes in the commodity cycle for hydrocarbon feedstocks and for chlor-alkali products. The principal factors impacting OxyVinyls' profitability include the PVC resin spread (which is the PVC resin selling price less the material cost of chlorine and ethylene), caustic soda selling prices, natural gas prices and customer product demand. The principal factors impacting SunBelt's profitability are caustic soda prices, chlorine prices and the cost of electricity. If the profitability of either OxyVinyls or SunBelt is adversely affected, we may receive less cash dividends from that partnership or we may choose to make additional cash contributions to that partnership, which could adversely affect our results of operations.

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

We depend upon integrated information systems to process orders, respond to customer inquiries, manage inventory, purchase, sell and ship goods on a timely basis, maintain cost-efficient operations, prepare financial information and reports, and operate our website. We may experience operating problems with our information systems as a result of system failures, viruses, computer "hackers" or other causes. Any significant disruption or slowdown of our systems could cause orders to be lost or delayed and could damage our reputation with our customers or cause our customers to cancel orders, which could adversely affect our results of operations.

***Our manufacturing operations are subject to hazards and other risks associated with polymer production and the related storage and transportation of raw materials, products and wastes.***

Our manufacturing operations are subject to the usual hazards and risks associated with polymer production and the related storage

and transportation of raw materials, products and wastes, including, but not limited to:

- explosions, fires, inclement weather and natural disasters;
- mechanical failure;
- unscheduled downtime;
- labor difficulties;
- inability to obtain or maintain any required licenses or permits;
- interruptions and environmental hazards such as chemical spills, discharges or releases of toxic or hazardous substances or gases into the environment or workplace; and
- storage tank leaks or other issues resulting from remedial activities.

The occurrence of any of these operating problems at our facilities may have a material adverse effect on the productivity and profitability of a particular manufacturing facility, or on our operations as a whole, during and after the period of these operating difficulties. These operating problems may also cause personal injury and loss of life, severe damage to or destruction of property and equipment, and environmental damage. In addition, individuals could seek damages for alleged personal injury or property damage due to exposure to chemicals at our facilities or to chemicals owned or controlled by us. Furthermore, we are subject to present and future claims with respect to workplace exposure, workers' compensation and other matters. Although we maintain property and casualty insurance of the types and in the amounts that we believe are customary for the industry, we are not fully insured against all potential hazards that are incident to our business.

***Extensive environmental, health and safety laws and regulations impact our operations and assets, and compliance with these regulations could adversely affect our results of operations.***

Our operations on and ownership of real property are subject to extensive environmental, health and safety laws and regulations at the national, state and local governmental levels. The nature of our business exposes us to risks of liability under these laws and regulations due to the production, storage, transportation, recycling or disposal and/or sale of materials that can cause contamination or personal injury if they are released into the environment or workplace. Environmental laws may have a significant effect on the costs of these activities involving raw materials, finished products and wastes. We may incur substantial costs, including fines, damages, criminal or civil sanctions, remediation costs, or experience interruptions in our operations for violations of these laws.

Also, federal and state environmental statutes impose strict, and under some circumstances, joint and several liability for the cost of investigations and remedial actions on any company that generated the waste, arranged for disposal of the waste, transported the waste to the disposal site or selected the disposal site, as well as on the owners and operators of these sites. Any or all of the responsible parties may be required to bear all of the costs of clean up, regardless of fault or legality of the waste disposal or ownership of the site, and may also be subject to liability for natural resource damages. We have been notified by federal and state environmental agencies and private parties that we may be a potentially responsible party in connection with several sites. We may incur substantial costs for some of these sites. It is possible that we will be identified as a potentially responsible party at more sites in the future, which could result in our being assessed substantial investigation or clean up costs.

We also conduct investigations and remediation at some of our active and inactive facilities, and have assumed responsibility for environmental liabilities based on operations at sites formerly owned or operated by our predecessors or by us.

We accrue costs for environmental matters that have been identified when it is probable that these costs will be required and when they can be reasonably estimated. However, accruals for estimated costs, including, among other things, the ranges associated with our accruals for future environmental compliance and remediation, may be too low or we may not be able to quantify the potential costs. We may be subject to additional environmental liabilities or potential liabilities that have not been identified. We expect that we will continue to be subject to increasingly stringent environmental, health and safety laws and regulations. We anticipate that compliance with these laws and regulations will continue to require significant capital expenditures and operating costs, which could adversely affect our results of operations or financial condition.

***We face competition from other polymer and chemical companies, which could adversely affect our sales and financial condition.***

We actively compete with companies that produce the same or similar products, and in some instances with companies that produce different products that are designed for the same end uses. We encounter competition in price, delivery, service, performance, product innovation, product recognition and quality, depending on the product involved.

Because of the polymer and chemical industry consolidation, our competitors may become larger, which could make them more efficient, thereby reducing their cost of materials and permitting them to be more price competitive. Increased size could also permit them to operate in wider geographic areas and enhance their ability to compete in other areas such as research and development and customer service, which could also reduce our profitability.

We expect that our competitors will continue to develop and introduce new and enhanced products, which could cause a decline in the market acceptance of our products. In addition, our competi-

tors could cause a reduction in the selling prices of some of our products as a result of intensified price competition. Competitive pressures can also result in the loss of major customers. An inability to compete successfully could have an adverse effect on our results of operations, financial condition and cash flows.

We may also experience increased competition from companies that offer products based on alternative technologies and processes that may be more competitive or better in price or performance, causing us to lose customers and result in a decline in our sales volume and earnings.

Additionally, some of our customers may already be or may become large enough to justify developing in-house production capabilities. Any significant reduction in customer orders as a result of a shift to in-house production could adversely affect our sales and operating profits.

***Our level of indebtedness may adversely affect our business.***

As of December 31, 2005, our debt totaled $646.5 million, which is 38% of our total assets. This level of indebtedness could have significant consequences, including:

- we may need to use a significant portion of our cash flow to repay principal and pay interest on our debt, which would reduce the amount of funds that would be available to finance our operations and other business activities;
- our debt level may make us vulnerable to economic downturns or adverse developments in our businesses and markets; and
- our debt level may limit our ability to pursue other business opportunities, implement our business strategies or borrow money for operations or capital expenditures in the future.

We expect to pay our expenses and pay principal and interest on our debt from cash provided by operating activities. Our ability to meet these payment obligations will depend upon our future financial performance, which could be affected by financial, business, economic and other factors.

We cannot control many of these factors, including economic conditions in the markets in which we operate. We cannot be certain that future cash provided by operating activities would be sufficient to allow us to pay principal and interest on our debt and meet our other obligations. If it is not sufficient, we may be unable to access our revolving credit facility or receivables sale facility as a result of breaching covenants in the agreements that govern our debt. We may also be required to refinance all or part of our existing debt, sell assets, borrow more money or issue additional equity. We cannot be sure that we will be able to do so on commercially reasonable terms or interest rates.

***Because our operations are conducted worldwide, they are affected by risks of doing business abroad.***

We generate export sales revenue from our operations conducted outside the United States as well as from our U.S. operations. Revenue from foreign operations (principally Canada, Mexico, Europe and Asia) amounted to 33% in 2005, 34% in 2004 and 35% in 2003 of our total revenue during these respective periods. Long-lived assets of our foreign operations represented 24% of our total long-lived assets at December 31, 2005, 2004 and 2003.

Our international operations are subject to risks of doing business abroad, including but not limited to the following:

- fluctuations in currency from devaluation, exchange rates or high inflation;
- transportation delays and interruptions;
- political and economic instability and disruptions;
- expropriation or nationalization of our property;
- risk of loss due to civil strife, acts of war, guerilla activities, insurrection and terrorism;
- restrictions on the transfer of funds or the ability to pay dividends offshore;
- limitations on our ability to invest in local businesses overseas;
- the imposition of duties and tariffs;
- import and export controls;
- changes in governmental policies and regulatory environments;
- labor unrest;
- disadvantages of competing against companies from countries that are not subject to U.S. laws and regulations, including the Foreign Corrupt Practices Act;
- the uncertainty of product acceptance by different cultures;
- the risks of divergent business expectations or cultural incompatibility that is inherent in establishing joint ventures with foreign partners;
- difficulties in staffing and managing multi-national operations;
- limitations on our ability to enforce legal rights and remedies;
- reduced protection of intellectual property rights in some countries;
- potentially adverse tax consequences; and
- other risks arising out of foreign sovereignty over the areas where our operations are conducted.

Any of these events could have an adverse effect on our future international operations by reducing the demand for our products or decreasing the prices at which we can sell our products, which could result in an adverse effect on our business, financial condition or results of operations. We may not be able to continue to operate in compliance with applicable customs, currency exchange control regulations, transfer pricing regulations or any other laws or regulations that we may be subject to. In addition, these laws or regulations may be modified in the future, and we may not be able to operate in compliance with those modifications.

***Other increases in operating costs could affect our profitability.***

Scheduled or unscheduled maintenance programs could cause significant production outages, higher costs and/or reduced production capacity at our equity affiliates and suppliers due to the industry in which they operate. The inability to achieve or the delay in achieving the anticipated financial benefits from our cost reduction initiatives and employee productivity goals could also affect our future profitability.

***We have a significant amount of goodwill, and any future goodwill impairment charges could adversely impact our results of operations.***

As of December 31, 2005, we had goodwill of $315.3 million on our balance sheet. We completed the annual impairment review required by Statement of Financial Accounting Standards No. 142, “Goodwill and Other Intangible Assets” (SFAS No. 142) during the third quarter of 2005, and determined that there was no impairment. However, the occurrence of a potential indicator of impairment, such as a significant adverse change in legal factors or business climate, an adverse action or assessment by a regulator, unanticipated competition, loss of key personnel or a more-likely-than-not expectation that a reporting unit or a significant portion of a reporting unit will be sold or disposed of, would require us to perform another valuation analysis, as required under SFAS No. 142, for some or all of our reporting units prior to the next required annual assessment. These types of events and the resulting analysis could result in additional charges for goodwill, which could adversely impact our results of operations.

***Lower investment performance by our pension plan assets may require us to increase our pension liability and expense, which may also lead us to accelerate funding of our pension obligations and divert funds from other potential uses.***

Lower investment performance by our pension plan assets or a decline in the stock market could result in an increase in our defined benefit pension plan obligations. We cannot predict whether changing economic conditions or other factors will require us to make contributions in excess of our current expectations, diverting funds that we could apply to other uses. As a result, we may need to modify our capital expenditure plans to meet our obligations. In addition, federal legislation has been proposed that could, if enacted, require us to increase our funding obligations and the premiums that we would pay to the Pension Benefit Guaranty Corporation. The impact of this legislation depends upon the requirements of the legislation, if enacted, and the investment performance of our pension plan assets, and could adversely affect our results of operations, financial position and cash flows.

***An inability to collect the remaining balances owed to us from purchasers of our former businesses could affect our financial position.***

In the third quarter of 2004, we sold our Elastomers and Performance Additives business, and in February 2006, we sold our Engineered Films business. These transactions included seller financing, where we retained notes receivable for a portion of the purchase price that is owed to us. The ability to collect these funds from the purchasers of these businesses depends upon the future results of operations, financial position and cash flows of the purchasers. The purchasers may not have the funds necessary to repay the principal and interest due to us on these notes when they become due.

***We have some employee benefit plans that are self-insured.***

Many of our U.S. employees participate in health care plans that we self-insure. We maintain a stop-loss insurance policy that covers the cost of certain individually large claims under these plans. Actual costs under these plans can be affected by rising medical costs, and are subject to variability depending primarily upon employee enrollment and demographics, the actual number and costs of claims made, and how much the stop-loss insurance we purchase covers the cost of these claims. If our cost estimates differ from actual costs, our results of operations and financial condition could be adversely impacted.

***Our business depends upon good relations with our employees.***

We may experience difficulties in maintaining appropriate relations with unions and employees in certain locations. About 4% of our employees at continuing operations are represented by, or are in negotiations to be represented by, labor unions. In addition, problems or changes affecting employees in certain locations may affect relations with our employees at other locations. The risk of labor disputes, work stoppages or other disruptions in production could adversely affect us. If we cannot successfully negotiate or renegotiate collective bargaining agreements or if the negotiations take an excessive amount of time, there may be a heightened risk of a prolonged work stoppage. Any work stoppage could have a material adverse effect in the productivity and profitability of a manufacturing facility or in our operations as a whole.

***The guarantee of our SunBelt joint venture’s debt could result in our having to pay the outstanding principal and interest if SunBelt cannot make these payments when due.***

We guaranteed $73.1 million of SunBelt’s outstanding senior secured notes at December 31, 2005 in connection with the construc-

tion of a chlor-alkali facility. These notes mature in 2017. If SunBelt is unable to make the future payments required on this debt as they come due, it could result in our having to make those payments on SunBelt's behalf, which could adversely impact our financial condition.

***The value of our intangible assets depends upon realizing future cash flows.***

Our intangible assets are primarily non-contractual customer relationships, sales contracts, patents and technology. The carrying value of each of these assets is reduced, if necessary, to its estimated net future cash flows at the end of each year, or more often if an indicator of impairment exists. There is no assurance that the future expected cash flows will be realized, which could negatively affect the carrying value or recoverability of these assets.

## ITEM 1B. UNRESOLVED STAFF COMMENTS

We have no outstanding or unresolved comments from the staff of the SEC.

## ITEM 2. PROPERTIES

As of December 31, 2005, we operated facilities in the United States and internationally. We own substantially all of our facilities. During 2005, we made effective use of our productive capacity at our principal facilities. We believe that the quality and productive capacity of our facilities is sufficient to maintain our competitive position for the foreseeable future. Following are the principal facilities of our segments:

### Continuing Operations

***Performance Plastics Facilities:***

| Vinyl Compounds | Colors and Additives | Engineered Materials | Polymer Coating Systems |
|---|---|---|---|
| Long Beach, California | Glendale, Arizona | Broadview Heights, Ohio | Los Angeles, California |
| Terre Haute, Indiana | Suwanee, Georgia | Macedonia, Ohio | Kennesaw, Georgia |
| Louisville, Kentucky | Elk Grove Village, Illinois | Dyersburg, Tennessee | St. Louis, Missouri |
| Plaquemine, Louisiana | St. Peters, Missouri | Suzhou, China | Sullivan, Missouri |
| Avon Lake, Ohio | Norwalk, Ohio | Shenzhen, China | Massillon, Ohio |
| Pasadena, Texas | Lehigh, Pennsylvania | Istanbul, Turkey | North Baltimore, Ohio |
| Niagara Falls, Ontario, Canada | Vonore, Tennessee | Gaggenau, Germany | Sussex, Wisconsin |
| Orangeville, Ontario, Canada | Seabrook, Texas | Jurong, Singapore | Melbourne, Australia |
| St. Remi de Napierville, Quebec, Canada | Assesse, Belgium | Barbastro, Spain | Bolton, England |
| Cartagena, Colombia (joint venture) | Pudong (Shanghai), China | Valleyfield, Quebec, Canada | Dartford, England |
| | Shenzhen, China | Clinton, Tennessee (joint venture) | Hyde, England |
| **Specialty Resins** | Glostrup, Denmark | | Widnes, England |
| Henry, Illinois | Cergy, France | | Shenzhen, China |
| Pedricktown, New Jersey | Tossiat, France | | |
| | Bendorf, Germany | | |
| | Gyor, Hungary | | |
| | Toluca, Mexico | | |
| | Pamplona, Spain | | |
| | Angered, Sweden | | |
| | Bangkok, Thailand | | |

***Distribution Facilities:***
Lemont, Illinois
Ayer, Massachusetts
Massillon, Ohio
Rancho Cucamonga, California
Statesville, North Carolina
Denver, Colorado
Chesterfield Township, Michigan
Eagan, Minnesota
Hazelwood, Missouri
Grand Prairie, Texas
Mississauga, Ontario, Canada

***Resin and Intermediates Facilities:***
OxyVinyls joint venture – various locations in North America
SunBelt joint venture – McIntosh, Alabama

### Discontinued Operations

***Engineered Films Facilities:***
Lebanon, Pennsylvania
Winchester, Virginia

**ITEM 3. LEGAL PROCEEDINGS**

In addition to the matters regarding the environment described in Item 1 under the heading “Environmental, Health and Safety,” we are involved in various pending or threatened claims, lawsuits and administrative proceedings, all arising from the ordinary course of business concerning commercial, product liability, employment and environmental matters that seek remedies or damages. We believe that the probability is remote that losses in excess of the amounts we have accrued could be materially adverse to our financial condition, results of operations or cash flows.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

No matters were submitted to a vote of security holders during the fourth quarter of 2005.

**EXECUTIVE OFFICERS OF THE COMPANY**
**(Included pursuant to Instruction 3 to paragraph (b) of Item 401 of Regulation S-K)**

The following table lists information, as of March 1, 2006, about each executive officer of our company, including his or her position with us as of that date and other positions held by him or her for at least the past five years. Executive officers are elected by our Board of Directors to serve one-year terms.

Stephen D. Newlin
Age: 53

Chairman, President and Chief Executive Officer, February 21, 2006 to date. President - Industrial Sector of Ecolab Inc. (global developer and marketer of cleaning and sanitizing specialty chemicals, products and services) from 2003 to 2006. Mr. Newlin served as President and a Director of Nalco Chemical Company (manufacturer of specialty chemicals, services and systems) from 1998 to 2001 and was Chief Operating Officer and Vice Chairman from 2000 to 2001. Mr. Newlin serves on the Board of Directors of Black Hills Corp. (NYSE: BKH).

Michael L. Rademacher
Age: 55

Vice President and General Manager, Distribution, September 2000 to date. Senior Vice President - Plastics Americas, M.A. Hanna Company, January 2000 to August 2000. Vice President and General Manager, Industrial Chemical and Solvents Division, Ashland Chemical Company (chemical manufacturing and distribution), 1998 to January 2000.

Robert M. Rosenau
Age: 51

Vice President and General Manager, North American Vinyl Compounds, January 2003 to date. General Manager, Extrusion Products, September 2000 to December 2002. General Manager, Custom Profile Compounds, The Geon Company, April 1998 to August 2000.

Wendy C. Shiba
Age: 55

Chief Legal Officer, November 2001 to date, and Vice President and Secretary, December 2001 to date. Vice President, Bowater Incorporated (pulp and paper), 1997 to November 2001, and Secretary and Assistant General Counsel, 1993 to November 2001.

Kenneth M. Smith
Age: 51

Chief Human Resources Officer, January 2003 to date, and Vice President and Chief Information Officer, September 2000 to date. Vice President, Information Technology, The Geon Company, May 1999 to August 2000, and Chief Information Officer, August 1997 to May 1999.

W. David Wilson
Age: 52

Vice President and Chief Financial Officer, September 2000 to date. Vice President and Chief Financial Officer, The Geon Company, May 1997 to August 2000.

**PART II**

## ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The following table sets forth the range of the high and low sale prices for our common stock, $.01 par value per share, as reported by the New York Stock Exchange, where the shares are traded under the symbol "POL," for the periods indicated.

| | 2005 Quarters | | | | 2004 Quarters | | | |
|---|---|---|---|---|---|---|---|---|
| | Fourth | Third | Second | First | Fourth | Third | Second | First |
| Common stock price: | | | | | | | | |
| High | $6.57 | $7.73 | $9.40 | $10.25 | $9.70 | $7.70 | $7.55 | $7.13 |
| Low | $5.31 | $5.75 | $6.00 | $ 8.05 | $7.00 | $6.22 | $6.30 | $5.28 |

As of March 13, 2006, there were 2,926 holders of record of our common stock.

Effective with the first quarter of 2003, we suspended payment of our quarterly dividend. Future declarations of dividends on common stock are at the discretion of the Board of Directors, and the declaration of any dividends will depend upon, among other things, earnings, capital requirements and our company's financial condition. The Board of Directors does not anticipate paying any dividends on common stock in the foreseeable future. Additionally, the indenture governing our 10.625% senior notes due in 2010 and the agreements that govern our revolving credit and receivables sale facilities contain restrictions that limit our ability to pay dividends.

## ITEM 6. SELECTED FINANCIAL DATA

| (In millions, except per share data) | 2005 | 2004 | 2003 | 2002 | 2001 |
|---|---|---|---|---|---|
| Sales | $2,450.6 | $2,267.7 | $2,048.1 | $1,981.1 | $2,019.3 |
| Operating income (loss) | $ 140.3 | $ 128.4 | $ (14.9) | $ 13.7 | $ (43.3) |
| Income (loss) before discontinued operations and change in accounting | $ 62.2 | $ 27.6 | $ (106.4) | $ (18.9) | $ (55.5) |
| Discontinued operations | (15.3) | (4.1) | (144.7) | 13.7 | 9.4 |
| Change in method of accounting | — | — | — | (53.7) | — |
| Net income (loss) | $ 46.9 | $ 23.5 | $ (251.1) | $ (58.9) | $ (46.1) |
| Basic and diluted earnings (loss) per share: | | | | | |
| Before discontinued operations and change in method of accounting | $ 0.68 | $ 0.30 | $ (1.17) | $ (0.21) | $ (0.62) |
| Discontinued operations | (0.17) | (0.04) | (1.59) | 0.15 | 0.11 |
| Change in method of accounting | — | — | — | (0.59) | — |
| Net income (loss) | $ 0.51 | $ 0.26 | $ (2.76) | $ (0.65) | $ (0.51) |
| Dividends per common share | $ — | $ — | $ — | $ 0.25 | $ 0.25 |
| Total assets | $1,716.0 | $1,774.8 | $1,900.9 | $1,997.5 | $2,051.5 |
| Long-term debt | $ 638.7 | $ 640.5 | $ 757.1 | $ 492.2 | $ 426.8 |

In August 2004, we sold our Elastomers and Performance Additives business, and in December 2002, we sold our 70% ownership in So.F.teR S.p.A. These businesses were previously reported as discontinued operations and are appropriately reflected as such in our historical results. In December 2002, we also acquired Transformacion de Pigmentos y Colorantes, S.A.

In December 2005, we announced that the Specialty Resins divestment process was unlikely to result in a sale of the business at acceptable terms. As a result, its financial results have been reclassified from discontinued operations to continuing operations for all historic periods presented as of December 31, 2005.

## ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### Purpose of Management's Discussion and Analysis (MD&A)

The purpose of the following discussion is to provide relevant information to investors who use our financial statements so they can assess our financial condition and results of operations by evaluating the amounts and certainty of cash flows from our operations and from outside sources.

The three principal objectives of MD&A are: to provide a narrative explanation of financial statements that enables investors to see our company through the eyes of management; to enhance overall financial disclosure and provide the context within which financial information should be analyzed; and to provide information about the quality and potential variability of earnings and cash flows so that investors can judge the likelihood that that past performance is indicative of future performance.

### Business Overview

We are a leading global compounding and North American distribution company with operations in thermoplastic compounds, specialty vinyl resins, specialty polymer formulations, color and additive systems, and thermoplastic resin distribution with equity investments in manufacturers of PVC resin and its intermediates. Headquartered in Avon Lake, Ohio, with 2005 sales of $2.5 billion, we have manufacturing sites and warehouses in North America, Europe and Asia, and joint ventures in North America and Colombia. We employ approximately 4,500 people, and sell more than 35,000 different specialty and commodity products to over 10,000 customers in 35 countries. 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).

### Recent Developments

***Sale of businesses and discontinued operations***

As of December 31, 2004, our Engineered Films and Specialty Resins businesses qualified for discontinued operations accounting treatment.

In September 2005, we announced that we had signed a letter of intent to sell our Engineered Films business. On February 15, 2006, we sold 82% of the Engineered Films business to an investor group consisting of members of the business' management team and Matrix Films, LLC for gross proceeds of $26.7 million before associated fees and costs. A cash payment of $20.5 million was received on the closing date and the remaining $6.2 million was in the form of a five-year note from the buyer. We do not expect to recognize any further gain or loss in 2006 from the transaction. We retained an 18% ownership interest in the company. All historical financial information for the Engineered Films business has been accounted for as a discontinued operation.

In December 2005, we announced that the Specialty Resins divestment process was unlikely to result in a sale of the business at acceptable terms. As a result, its financial results have been reclassified from discontinued operations to continuing operations for all periods as of December 31, 2005. It is now included in the Performance Plastics segment, where it had been previously.

Unless otherwise noted, disclosures contained in this report relate to continuing operations. For more information about our discontinued operations see Note B to the Consolidated Financial Statements.

***Purchase of businesses***

In January 2005, we completed the purchase of the remaining 16% of equity ownership in Star Color, a color additives manufacturing subsidiary in Thailand, for $1.6 million. This business is included in the Performance Plastics segment.

In May 2005, we purchased equipment, compounding recipes and a customer list from Novatec Plastics Corporation, a compounding business owned by PVC Container Corporation, for $1.1 million. These assets are included in the Performance Plastics segment and are used to serve our customers in the custom profile and custom molding markets.

***Executive management changes***

In October 2005, Thomas A. Waltermire resigned as our president and chief executive officer and as a director. William F. Patient, non-executive chairman of the board, served as interim chief executive officer until a permanent successor was named.

In January 2006, V. Lance Mitchell, group vice president and general manager of Color and Engineered Materials, resigned to accept a position with another company. Robert Bindner, director of sales for Color and Additives, is filling this position until a permanent successor is selected. Mr. Bindner will continue to handle his current duties in the interim.

In February 2006, Stephen D. Newlin joined the company as chairman, president and chief executive officer. He was president of the Industrial Sector of Ecolab, Inc. from 2003 to 2006, and prior to that was president and a director with Nalco Chemical Company from 1998 to 2001 and served as chief operating officer and vice-chairman from 2000 to 2001.

***Restructuring initiatives and facility closures***

In November 2005, we announced that we would close our Manchester, England plastic color additives facility to reduce costs and align capacity with market demand. Production is being phased

out while business with key customers is either being transitioned to other PolyOne facilities or customers secure alternative sources for products. The facility had 44 employees. A charge to operating income of $0.5 million was made in the fourth quarter of 2005, and we estimate that an additional charge of $0.3 million will be recognized in the first quarter of 2006 to complete the plant phaseout. We expect that the process will be completed by the end of the first quarter of 2006.

**Outlook**

Business demand was strong at the end of 2005, particularly following the disruptive events associated with the two hurricanes that negatively affected operations and raw material availability on the U.S. Gulf Coast. It appears that early 2006 global business demand is higher than in early 2005. This strength appears in all three regions where we operate: North America, Europe and Asia. Adding to the optimism in North America is the expectation that energy costs should decline in 2006 compared with 2005, which should benefit us in terms of lower operating and raw material costs.

While projections show North American interest rates rising in 2006, housing construction and remodeling activity is expected to decline only moderately from 2005 levels. Some of this demand in early 2006 should result from rebuilding areas damaged by the hurricanes. Building materials represent approximately 25% of our annual sales.

North American automobile and light truck build rates slowed significantly in late 2005, particularly among the “Big Three” domestic manufacturers. Early 2006 build rates are expected to lag behind 2005 rates, particularly for the Big Three, which depend on truck and SUV sales that are slowing due to higher gasoline prices. Automotive applications represent approximately 9% of our annual sales.

Forecasts show U.S. Industrial Production increasing 3% to 4%. Our view is that real plastics growth in North America will be up by 1% to 3% in 2006 compared with 2005.

In late 2005, Europe continued to experience slow growth, which characterized business conditions there throughout 2005. Entering 2006, however, there are signs that business conditions may be improving, especially in Germany and France, our two largest European markets. Our view is that overall industrial demand, and plastics demand in particular, will be up slightly, by approximately 1% in 2006 compared with 2005.

Asian business slowed slightly in late 2005, but expectations remain for a robust 2006. Adding to our optimism is the building momentum in orders for our new manufacturing facility in south China. This plant is expected to capture the increasing growth in the region. For Asia, projections show plastics market growth of 5% to 7% in 2006. Growth in China is expected to continue at a 10% to 15% annual pace.

Oil- and natural gas-derived hydrocarbon feedstock pricing, which spiked in late 2005 due to hurricane-related outages, is expected to decrease in 2006. As a result, price trends for key raw materials should be flat or slightly down compared with 2005. Throughout 2006, however, chlorine and caustic soda prices should remain near the levels achieved at the end of 2005, as industry production utilization levels remain very high. This situation bodes particularly well for SunBelt, which had record earnings in 2005. OxyVinyls should have another solid year, with polyvinyl chloride resin manufacturing utilization levels remaining near capacity. Moderating ethylene and natural gas costs should also help to improve results. These trends should benefit the Resin and Intermediates segment, which is expected to generate earnings close to the record levels it achieved during 2005.

One of our main objectives in the second half of 2005 was to increase spreads (selling price less raw material costs) for products within the Performance Plastics segment. We believe that we entered 2006 with these spreads at higher levels than they were at the start of 2005. In particular, our Vinyl Compounds and Engineered Materials product groups, as well as our Distribution segment, achieved significant price increases during the fourth quarter of 2005. Maintaining and even expanding these spreads is key to improving the operating earnings of the Performance Plastics segment in 2006.

We also will focus on continuing to strengthen our market positions in 2006. We have specific growth targets and have charged our managers with gaining market share. In addition, we are implementing specific plans to bring three product groups, North American Color, North American Engineered Materials and the newly formed Producer Services, to a combined level of profitability in 2006. We expect to achieve this through a combination of shipment volume growth, product line upgrades to more specialty materials, manufacturing cost reductions and productivity enhancements. Since our formation, in the aggregate, these product groups have not been profitable.

We are also committed to maintaining control of overhead costs. We expect to keep selling and administrative costs as a percentage of sales to 8% or less. In addition, we are focused on holding the growth in working capital to less than the rate of sales growth.

We expect these additional factors to affect 2006 cash flow:

- capital expenditures should be $45 million to $50 million compared with 2005 spending of $33 million, due largely to higher spending in support of growth initiatives;
- depreciation and amortization should be approximately $55 million (including Specialty Resins, which is now included in continuing operations);
- cash distributions from equity affiliates should approximate 2005 levels, provided that there is no material change in the operating conditions of our equity affiliates;

- we received a cash payment of $20.5 million in February 2006 upon the sale of the Engineered Films business;
- we anticipate receiving proceeds of approximately $15 million to $25 million from various legal matters including insurance coverage and antitrust claims, which were settled in our favor in the fourth quarter of 2005 and first quarter of 2006;
- we anticipate receiving gross proceeds of approximately $5 million to $10 million from the sale of previously closed facilities and redundant assets in 2006;
- restructuring expenditures should be minimal;
- cash income taxes (foreign and state) should be similar to 2005, at $10 million to $12 million;
- no contributions to our qualified U.S. pension plan will be required in 2006;
- less than $1 million is due on debt maturing in 2006; and
- interest expense should be approximately $4 million to $5 million lower in 2006 compared with 2005 as a result of debt reductions.

**Results of Operations**

***Summary of Consolidated Results:***

Income from continuing operations improved by $35 million, or $0.38 per share. Sales increased by 8% from last year; however, our sales growth was driven in part by higher raw material, distribution and energy costs that we were able to partially recapture with selling price increases. Our sales volume declined by 5% in our Performance Plastics segment and by 2% in our Distribution segment. The majority of our customers experienced softer demand in their end markets, which affected their demand for our products. The domestic and international business environment remained very competitive.

The negative impact of the year-over-year volume decline, however, was offset by a $24 million reduction in selling and administrative costs and $4 million less in interest expense. Lower interest expense was the result of strong cash generated from operating activities, which allowed us to reduce debt by $46 million in 2005. Also, for the second year in a row, we funded working capital needs resulting from increased sales by improving our management of accounts receivable, inventories and accounts payable. Though higher sales levels would have otherwise consumed $35 million in additional cash to fund these working capital needs, improved collection periods and inventory turns allowed us to generate $34 million in cash in 2005, offsetting the effect of higher sales on working capital.

Strong earnings from our equity affiliate and minority interest investments in 2005, up $14 million due to improved profitability from our Resins and Intermediates segment, helped to offset the impact of the volume decline on pre-tax earnings. OxyVinyls benefited from higher industry-wide margins on PVC resin and vinyl chloride monomer that resulted from favorable supply and demand dynamics combined with improved chlor-alkali profitability. Results in the third quarter, however, were tempered by hurricane-related production interruptions and a $22.9 million non-cash impairment charge that was related to a previously idled chlor-alkali facility. SunBelt's earnings improvement was largely due to higher selling prices for chlorine and caustic soda, again driven by favorable supply and demand dynamics.

Our primary objectives in 2006 are to grow sales volume through organic business growth, maintain or restore product spreads, continue to contain selling and administrative costs, continue to drive working capital improvements to fund sales growth with a minimum investment, and generate strong cash flow from operating activities to improve our financial flexibility by reducing debt, increasing liquidity and strengthening our balance sheet.

| (In millions) | 2005 | 2004 | 2003 |
|---|---|---|---|
| **Sales:** | | | |
| Performance Plastics segment | $1,925.4 | $1,803.7 | $1,640.1 |
| Distribution segment | 679.2 | 606.3 | 529.2 |
| Intersegment eliminations | (154.0) | (142.3) | (121.2) |
| Total sales | $2,450.6 | $2,267.7 | $2,048.1 |
| **Net income (loss):** | | | |
| Performance Plastics segment | $ 62.8 | $ 83.5 | $ (7.2) |
| Distribution segment | 19.5 | 17.8 | 5.8 |
| Resin and Intermediates segment | 67.1 | 49.2 | 20.8 |
| Other segment | (9.1) | (22.1) | (34.3) |
| Operating income (loss) | 140.3 | 128.4 | (14.9) |
| Interest expense | (68.1) | (72.1) | (66.6) |
| Interest income | 1.9 | 1.5 | 0.9 |
| Other expense, net | (5.3) | (16.5) | (13.3) |
| Income (loss) before income tax | 68.8 | 41.3 | (93.9) |
| Income tax expense | (6.6) | (13.7) | (12.5) |
| Income (loss) from continuing operations | 62.2 | 27.6 | (106.4) |
| Loss from discontinued operations, net of taxes | (15.3) | (4.1) | (144.7) |
| Net income (loss) | $ 46.9 | $ 23.5 | $ (251.1) |

Year-to-year changes in sales and operating income (loss) are discussed in the "Segment Information" section that follows. Segments are also discussed in detail in Note R to the Consolidated Financial Statements.

***Selected Operating Costs:***

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

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| Cost of sales | 87.9% | 85.3% | 84.8% |
| Selling and administrative costs | 7.3% | 8.9% | 12.0% |

***Cost of Sales*** – These costs, as a percentage of sales, increased in 2005 from 2004 and 2003 levels primarily as a result of raw material, transportation and energy cost increases that were partially offset by selling price increases and manufacturing cost reduction initiatives.

***Selling and Administrative*** – These costs, as a percentage of sales, declined in 2005 and 2004 primarily due to administrative restructuring and cost reduction initiatives that resulted in lower wage and benefit costs. The decline of $23.7 million in 2005 from 2004 includes an $8.8 million benefit in 2005 from settling legal issues. The decline of $42.9 million in 2004 from 2003 includes a $4.0 million benefit in 2004 from settling legal issues and from executive life insurance proceeds.

***Comparability of Earnings:***

The following expenses (benefits) affect year-over-year comparisons of operating income (loss), organized by the line item on the Consolidated Statements of Operations where each expense (benefit) is reflected:

| (In millions) | 2005 | 2004 | 2003 |
|---|---|---|---|
| Separate line items: | | | |
| Employee separation and plant phaseout | $ 5.5 | $(1.4) | $35.7 |
| Asset impairments | 0.4 | 3.8 | 19.4 |
| Environmental remediation at inactive sites | 0.9 | 8.7 | 2.7 |
| Loss on sale of assets | — | 5.9 | 0.3 |
| Selling and administrative: | | | |
| Settlement of legal issues | (8.8) | (2.1) | — |
| Executive life insurance proceeds | — | (1.9) | — |
| Income from equity affiliates and minority interest: | | | |
| Impairment of a previously idled chlor-alkali facility at OxyVinyls | 22.9 | — | — |
| Equity investment restructuring costs and cumulative effect of an accounting change | — | — | 1.8 |

***Employee Separation and Plant Phaseout*** – Severance, employee outplacement, lease termination, facility closing costs and the write-down of the carrying value of plant and equipment resulting from the consolidation of operations, restructuring initiatives and executive separation agreements. For more information about our employee separation and plant phaseout activities, see Note E to the Consolidated Financial Statements.

***Asset Impairments*** – Charges to adjust the carrying values of intangible assets and other investments to expected net future cash flows resulting from an evaluation done each year-end, or more often when indicators of impairment exist. These charges are non-cash and will not result in future cash expenditures.

| (In millions) | 2005 | 2004 | 2003 |
|---|---|---|---|
| Internet investments | $0.2 | $0.2 | $ 1.6 |
| Community development investments | 0.2 | 0.3 | — |
| Customer contract – lower profit expectations | — | 3.3 | — |
| Impairment of Specialty Resins business(1) | — | — | 11.4 |
| Customer lists – lower profit expectations | — | — | 4.3 |
| Note receivable | — | — | 1.4 |
| Technology investment deemed to be not marketable | — | — | 0.7 |
| | $0.4 | $3.8 | $19.4 |

(1) When we decided to sell the Specialty Resins business in 2003, we adjusted the carrying value of the business to estimated future net proceeds and classified the business as being held for sale within discontinued operations. When we determined that the divestment process was unlikely to result in a sale of the business at acceptable terms in the fourth quarter of 2005, we reclassified Specialty Resins to continuing operations for all historic periods presented as of December 31, 2005.

***Environmental Remediation at Inactive Sites*** – Environmental remediation costs for manufacturing facilities that we either no longer own or that we closed in prior years. We increased our reserves significantly in 2004 to reflect a reduction in expected recoveries from an insurance company whose policies now only service remaining liabilities for groundwater remediation costs at a site that we no longer own and to recognize an increase over previous cost estimates for a remedial action work plan at an inactive site.

***Loss on Sale of Assets*** – We sold the assets of our European Melos rubber granulates operations in 2004 and European vinyl compounding business in 2003.

***Settlement of Legal Issues*** – The net benefit from settling legal issues.

***Other Components of Income and Expense:***

Following are discussions of significant components of income and expense that are presented below the line “operating income (loss)”.

***Interest Expense*** – Changes in interest expense from year to year are largely the result of changes in average borrowing levels. At December 31, 2002, our total debt was $583.9 million. In the second quarter of 2003, we issued $300 million of 10.625% senior

notes, bringing our total debt to $854.3 million at June 30, 2003. Since then, our total debt has declined each quarter. Total debt was $646.5 million at December 31, 2005.

The following table presents the quarterly average of short- and long-term debt for the past three years and the related interest expense:

| (In millions) | 2005 | 2004 | 2003 |
|---|---|---|---|
| Short-term bank debt | $ 4.5 | $ 2.1 | $ 8.0 |
| Current portion of long-term debt | 35.2 | 34.4 | 53.2 |
| Long-term debt | 639.5 | 716.8 | 665.8 |
| Quarterly average | $679.2 | $753.3 | $727.0 |
| Interest expense | $ 68.1 | $ 72.1 | $ 66.6 |

***Other Expense, Net*** – Finance costs associated with our receivables sale facility, foreign currency gains and losses, retained post-employment benefit costs from previously discontinued operations, premiums paid in connection with the repurchase of senior notes maturing in the third quarter of 2004 and other miscellaneous items.

| (In millions) | 2005 | 2004 | 2003 |
|---|---|---|---|
| Currency exchange gain (loss), net of foreign exchange contracts | $ 0.5 | $ (4.1) | $ (5.0) |
| Discount on sale of trade receivables | (5.5) | (6.1) | (5.9) |
| Retained post-employment benefit costs related to previously discontinued operations | (1.3) | (3.6) | (3.0) |
| Premium paid on debt repurchase | — | (3.3) | — |
| Other income, net | 1.0 | 0.6 | 0.6 |
| | $(5.3) | $(16.5) | $(13.3) |

***Income Tax Expense*** – Income taxes are discussed in detail in Note P to the Consolidated Financial Statements. Income tax expense is primarily related to foreign earnings and state income taxes. In 2005, we recorded tax expense on domestic income at a rate lower than the federal statutory rate because we reversed a portion of our tax asset valuation allowance. In 2004 and 2003, we did not record a tax benefit on domestic losses due to uncertainty about whether we will fully realize the net deferred tax assets that were generated by domestic losses. We intend to maintain a valuation allowance until positive evidence exists that it is more likely than not that these assets will be realized.

***Loss from Discontinued Operations, Net of Income Taxes*** – Discontinued operations are discussed in detail in Note B to the Consolidated Financial Statements. The loss from discontinued operations included a pre-tax benefit of $0.2 million in 2005, and pre-tax charges of $7.5 million in 2004 and $26.4 million in 2003 for employee separation and plant phaseout costs from restructuring initiatives and closing certain manufacturing facilities of the Engineered Films and Elastomers and Performance Additives businesses.

As required by generally accepted accounting principles in the United States, 2005 and 2004 loss from discontinued operations does not include any depreciation or amortization expense.

| (In millions) | 2005 | 2004 | 2003 |
|---|---|---|---|
| Sales: | | | |
| Elastomers and Performance Additives | $ — | $220.1 | $ 348.1 |
| Engineered Films | 119.6 | 125.7 | 139.3 |
| | $119.6 | $345.8 | $ 487.4 |
| Pre-tax income (loss) from operations: | | | |
| Elastomers and Performance Additives | $ — | $ 17.2 | $ 3.5 |
| Engineered Films | 0.5 | 0.6 | (27.9) |
| | 0.5 | 17.8 | (24.4) |
| Pre-tax charges to adjust net assets of businesses held for sale to projected net sale proceeds: | | | |
| Elastomers and Performance Additives | (0.7) | (17.0) | (92.6) |
| Engineered Films | (15.1) | (4.3) | (26.5) |
| | (15.3) | (3.5) | (143.5) |
| Income tax expense (net of valuation allowance) | — | (0.6) | (1.2) |
| Loss from discontinued operations | $ (15.3) | $ (4.1) | $(144.7) |

Table of Contents

***Segment Information:***

*2005 Compared with 2004:*

| (In millions) | 2005 | 2004 | Change | % Change |
|---|---|---|---|---|
| Sales: | | | | |
| Performance Plastics segment | $1,925.4 | $1,803.7 | $121.7 | 7% |
| Distribution segment | 679.2 | 606.3 | 72.9 | 12% |
| Intersegment eliminations | (154.0) | (142.3) | (11.7) | (8)% |
| | $2,450.6 | $2,267.7 | $182.9 | 8% |
| Operating income (loss): | | | | |
| Performance Plastics segment | $ 62.8 | $ 83.5 | $ (20.7) | |
| Distribution segment | 19.5 | 17.8 | 1.7 | |
| Resin and Intermediates segment | 67.1 | 49.2 | 17.9 | |
| Other segment | (9.1) | (22.1) | 13.0 | |
| | $ 140.3 | $ 128.4 | $ 11.9 | |
| Operating income as a percentage of sales: | | | | |
| Performance Plastics segment | 3.3% | 4.6% | (1.3)%points | |
| Distribution segment | 2.9% | 2.9% | — | |
| Total | 5.7% | 5.7% | — | |

Performance Plastics 2005 sales increased by 7% while shipment volume declined by 5% from 2004. Following is a breakdown of 2005 sales by product group, along with percentage changes from 2004 in sales and shipment volume:

| | 2005 Sales % of Total | 2005 Sales % Change vs. 2004 | 2005 Shipment Lbs. % Change vs. 2004 |
|---|---|---|---|
| Vinyl Compounds | 40% | 8% | (4)% |
| North American Colors and Additives | 13% | 8% | 3% |
| North American Engineered Materials | 6% | 0% | (7)% |
| International Colors and Engineered Materials | 25% | 2% | (11)% |
| Polymer Coating Systems | 9% | 2% | (6)% |
| Specialty Resins | 7% | 29% | (3)% |
| Total Performance Plastics | 100% | 7% | (5)% |

Vinyl Compounds volume was down due to softer demand in virtually all markets except custom extrusions and fittings. The majority of our customers experienced softer market conditions, which negatively affected their demand for our products. This decline in volume was partially offset by new business obtained in custom extrusion and wire & cable applications. Higher average selling prices from efforts to recapture increases in the cost of resin and non-resin raw materials was the primary driver of the sales increase.

North American Colors and Additives volume improved from new business that we obtained in construction material applications and for contract tolling (compounding using customer-supplied materials), partially offset by reduced demand in packaging, pipe & fittings and film market platforms. This net volume gain, combined with a favorable shift in product mix within our contract tolling business, helped to increase sales. The sales increase was also the result of higher average selling prices from our efforts to recapture raw material cost increases as well as the nature of some of our business where selling prices are more closely tied to raw material indices.

North American Engineered Materials volume declined primarily from lower demand for certain general-purpose and contract manufactured automotive applications because these customers used less of these materials in the same applications, combined with a general slowing in automotive production levels that began early in the second half of the year. Higher average selling prices from efforts to recapture raw material cost increases, combined with a shift in product mix toward higher-priced products used in specific automotive applications, helped to hold sales level with the prior year.

International Colors and Engineered Materials volume declined 11%. The May 2004 sale of the Melos rubber granules business accounted for 9 percentage points of the year-over-year volume decline. The balance of the volume decline was primarily the result of weakness in demand for certain engineered materials applications and a general weakness in European plastics markets that was partially offset by higher volume in Asia, strengthened by our new manufacturing facility in Shenzhen, China that began operations in the second quarter of 2005. This plant manufactures engineered material compounds, color compounds and plastisol inks. Higher average selling prices from efforts to recapture raw material cost increases, combined with favorable euro to U.S. dollar currency exchange rates totaling approximately $3 million, contributed to a sales increase of 2%. The sale of the Melos rubber granules business negatively affected the year-over-year revenue comparison by 3 percentage points.

Polymer Coating Systems volume declined primarily due to a decline in automotive demand caused mainly by reduced production schedules and platform build-outs. Some customers with their own compounding capability also decided to bring some of their plastisol requirements in-house to utilize their internal capacity more fully, which reduced our volume. Higher average selling prices from efforts to recapture raw material cost increases drove the sales increase.

Specialty Resins volume fell in the second half primarily as the result of slower overall market conditions combined with increased competition from lower-priced imported resin. Higher average selling prices resulting from efforts to restore product spreads by recapturing raw material cost increases were the main drivers of the sales increase.

Performance Plastics operating income, as a percentage of sales, declined by 1.3 percentage points. The main drivers were lower volumes, increased raw material costs and increased energy costs across virtually all product lines. Selling price increases only partially offset the impact of higher costs. Ongoing manufacturing, selling and administrative expense reduction efforts helped to partially offset the negative impact of rising raw material costs. Expenses affecting the comparability of earnings for employee separation and plant phaseout, environmental remediation costs at inactive sites, asset impairments and loss on the sale of assets were $3.0 million in 2005 and $7.4 million in 2004.

The Distribution volume decline was primarily in commodity resins, consistent with the general softening across the North American plastics industry during the second quarter experienced by our Performance Plastics segment. Selling price increases that were passed through from our supplier base and a shift in product mix toward higher-priced products drove the sales increase.

Distribution operating income as a percentage of sales remained level with the prior year. The effect of lower volumes and material cost increases were offset by higher selling prices. Operating costs were consistent with the prior year.

Resin and Intermediates operating income increased $17.9 million, the result of a $29.0 million increase in SunBelt’s equity earnings contribution, partially offset by a $16.8 million decline in OxyVinyls’ equity earnings contribution, which included a $22.9 million non-cash impairment charge in 2005 that was related to a previously idled chlor-alkali facility at OxyVinyls. OxyVinyls benefited from higher industry average PVC resin and VCM product spreads that resulted from favorable supply/demand dynamics and improved chlor-alkali profitability as compared to last year. This benefit was tempered in the third quarter by the adverse impact of the combination of hurricane-related production interruptions and significant increases in ethylene and natural gas costs. SunBelt’s earnings improvement was largely from significantly higher combined selling prices for chlorine and caustic soda that was driven by favorable supply and demand dynamics.

“Other” consists primarily of corporate general and administrative costs that were not allocated to business segments and inter-segment sales and profit eliminations. The 2005 net expense was $13.0 million lower as compared to 2004. The following expenses (benefits) impact the year-over-year comparison:

| (In millions) | 2005 | 2004 | Change |
|---|---|---|---|
| Employee separation and plant phaseout charges | $ 3.1 | $ 0.4 | $ 2.7 |
| Environmental remediation costs at inactive sites | (2.6) | 8.7 | (11.3) |
| Asset impairments | 0.4 | 0.5 | (0.1) |
| Settlement of legal issues and related reserves | (8.8) | (2.1) | (6.7) |
| Executive life insurance proceeds | — | (1.9) | 1.9 |

*2004 Compared with 2003:*

| (In millions) | 2004 | 2003 | Change | % Change |
|---|---|---|---|---|
| Sales: | | | | |
| Performance Plastics segment | $1,803.7 | $1,640.1 | $163.6 | 10% |
| Distribution segment | 606.3 | 529.2 | 77.1 | 15% |
| Intersegment eliminations | (142.3) | (121.2) | (21.1) | 17% |
| | $2,267.7 | $2,048.1 | $219.6 | 11% |
| Operating income (loss): | | | | |
| Performance Plastics segment | $ 83.5 | $ (7.2) | $ 90.7 | |
| Distribution segment | 17.8 | 5.8 | 12.0 | |
| Resin and Intermediates segment | 49.2 | 20.8 | 28.4 | |
| Other segment | (22.1) | (34.3) | 12.2 | |
| | $ 128.4 | $ (14.9) | $143.3 | |
| Operating income (loss) as a percentage of sales: | | | | |
| Performance Plastics segment | 4.6% | (0.4)% | 5.0%points | |
| Distribution segment | 2.9% | 1.1% | 1.8%points | |
| Total | 5.7% | (0.7)% | 6.4%points | |

Performance Plastics 2004 sales increased 10% while shipment volume increased 4% from 2003. Following is a breakdown of 2004 sales by product group, along with percentage changes from 2003 in sales and shipment volume:

| | 2004 Sales % of Total | 2004 Sales % Change vs. 2003 | 2004 Shipment Lbs. % Change vs. 2003 |
|---|---|---|---|
| Vinyl Compounds | 40% | 12% | 9% |
| North American Colors and Additives | 13% | 12% | 23% |
| North American Engineered Materials | 6% | 4% | (10)% |
| International Colors and Engineered Materials | 26% | 8% | (9)% |
| Polymer Coating Systems | 9% | 2% | (3)% |
| Specialty Resins | 6% | 26% | 19% |
| Total Performance Plastics | 100% | 10% | 4% |

Vinyl Compounds volume was up due to stronger demand in the wire and cable, construction and telecommunications markets. Higher average selling prices, resulting from efforts to offset raw material cost increases, combined with higher volume, drove the sales increase.

North American Colors and Additives volume was up from stronger demand in extrusion profile applications, higher contract compounding volume and a new application for outdoor decking. Lower selling prices for contract compounding, where raw materials are supplied by the customer, combined with lower average selling prices in the extrusion profile market, resulted in a sales increase that was less than the volume increase.

North American Engineered Materials volume was down as a result of softer demand in toll compounding applications for the automotive market. Sales increased due to a higher-priced mix of proprietary and customer-tolled products for automotive and telecommunication applications combined with efforts to offset raw material cost increases in our selling prices.

International Colors and Engineered Materials total volume declined 9%. The May 2004 sale of the Melos rubber granules business, however, negatively impacted the year-over-year volume comparison by 24 percentage points. Therefore, excluding Melos, volume increased 13% reflecting stronger demand in both Asia and Europe. Higher average selling prices from efforts to offset raw material cost increases and favorable euro to U.S. dollar currency exchange rates totaling approximately $35 million contributed to the 8% sales increase. The sale of the Melos rubber granules business negatively affected the year-over-year sales comparison by 6 percentage points.

Polymer Coating Systems volume was down primarily from lower plastisol and powder volumes for automotive applications on models that have been phased out. This decline was partially offset by higher volumes in inks. Sales increased from the resulting change in product mix, combined with higher average selling prices resulting from efforts to offset raw material cost increases.

Specialty Resins volume increased from stronger customer end market demand and a production capacity constraint in the market that resulted from the shutdown of a competitor's production facility. The primary drivers of the sales increase were the volume improvement and higher selling prices that partially offset significant increases in the cost of vinyl chloride monomer, the primary raw material used in the production of resin.

Performance Plastics operating income, as a percentage of sales, improved by 5.0 percentage points. The main drivers were higher volumes combined with lower costs that resulted from manufacturing, selling and administrative restructuring and cost reduction initiatives. Favorable currency translation also added approximately $3 million to earnings. Raw material cost increases, however, generally outpaced our ability to raise prices during 2004. Expenses affecting the comparability of earnings for employee separation and plant phaseout, asset impairments and loss on the sale of assets were $7.4 million in 2004 and $41.6 million in 2003.

Distribution volume increased as the result of stronger demand for PolyOne-produced products, third-party commodity resins and the January 2004 acquisition of the North American business of ResinDirect, a subsidiary of Louis Dreyfus Energy Services. These increases were partially offset by volume declines in Mexico that resulted from exiting a portion of the business during the first half of 2003 and subsequently exporting from the United States. The sales increase outpaced the volume increase due to selling price increases from our supplier base that we passed through to our customers.

Distribution operating income as a percentage of sales improved by 1.8 percentage points. The main drivers were increased volumes in the United States and Canada, combined with cost savings resulting from restructuring initiatives and closing the Mexican Distribution operation in 2003. Operating income in 2003 also included a $1.6 million charge for employee separation and plant phaseout costs.

Resin and Intermediates operating income increased $28.4 million as the result of a $25.8 million increase in OxyVinyls' earnings contribution and a $2.3 million increase in SunBelt's earnings contribution. Results in 2003 also included a $1.8 million charge for restructuring costs and the cumulative effect of an accounting change at OxyVinyls. OxyVinyls' earnings improved due to favorable supply and demand dynamics that drove improved operating margins for PVC and VCM. SunBelt's earnings were up from increased volume and higher margins on chlorine and caustic soda sales. "Other" consists primarily of corporate general and administrative costs that were not allocated to business segments and inter-segment sales and profit eliminations. The net expense was

Table of Contents

$12.2 million lower in 2004 than in 2003. The following expenses (benefits) impact the year-over-year comparison:

| (In millions) | 2004 | 2003 | Change |
|---|---|---|---|
| Employee separation and plant phaseout charges | $ 0.4 | $8.9 | $(8.5) |
| Environmental remediation costs at inactive sites | 8.7 | 2.7 | 6.0 |
| Loss on sale of assets | — | 0.3 | (0.3) |
| Asset impairments | 0.5 | 1.6 | (1.1) |
| Settlement of legal issues and related reserves | (2.1) | — | (2.1) |
| Executive life insurance proceeds | (1.9) | — | (1.9) |

For more information about our segments, see Note R to the Consolidated Financial Statements.

### Impact of Inflation

Although inflation has slowed in recent years, we believe it is still a factor in our economy, and we continually seek ways to mitigate its impact. To the extent permitted by competition, we pass on increased costs to our customers by increasing sales prices over time. The primary raw material in our Performance Plastics segment is PVC resin. The price of PVC resin fluctuates in tandem with the cost of raw materials (primarily ethylene and chlorine) and natural gas that are used in the manufacture of PVC resin, as well as supply and demand. As a result, our selling prices can also decline in periods of declining PVC resin costs. Our sales growth in 2004 and 2005 is due in part to selling price increases that partially recaptured higher raw material, distribution and energy costs.

We use the last-in, first-out (LIFO) method of accounting for 39% of our inventories and the first-in, first-out (FIFO) or average cost method for the remainder. Under the LIFO method, the cost of products sold that are reported in the financial statements approximates current costs, providing a better match of current period revenue and expenses. Charges to operations for depreciation represent the allocation of historical costs incurred over past years and are lower than if they were based on the current cost of the productive capacity being consumed.

### Accounting Policies and Estimates

Significant accounting policies are described more fully in Note C to the Consolidated Financial Statements. 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 these estimates. We believe that the following discussion addresses our most critical accounting policies, which are those that are the most important to the portrayal of our financial condition and results of operations and require our most difficult, subjective and complex judgments.

***Sales Discounts and Rebates*** – Sales discounts and rebates are offered to certain customers to promote customer loyalty and to encourage greater product sales. These programs provide customers with credits against their purchases if they attain pre-established volumes or revenue milestones for a specific period. We estimate the provision for rebates based upon the specific terms of each agreement at the time of shipment and an estimate of the customer's future achievement of the respective volume or revenue milestones. The actual amounts earned can differ from these estimates. In the past, the actual amounts earned by our customers have not differed materially from our estimates.

***Allowance for Doubtful Accounts*** – Allowances for doubtful accounts are determined based upon estimates of losses related to customer receivable balances. In establishing the appropriate provisions for customer receivable balances, we make assumptions about their future collectibility. Our assumptions are based on an individual assessment of each customer's credit quality as well as subjective factors and trends, including the aging of receivable balances. We regularly analyze significant customer accounts and record a specific reserve to reduce the related receivable to the amount we reasonably believe is collectible when we become aware of a customer's inability to meet its financial obligations to us, such as in the case of a bankruptcy filing or deterioration in the customer's operating results or financial position. We also record reserves for all other customers based on a variety of factors, including the length of time the receivables are past due, the financial health of the customer, economic conditions and our historical experience. If circumstances related to specific customers change, our estimates of the collectibility of receivables may be adjusted further. In the past, the actual losses incurred have differed from our estimates primarily as a result of unforeseen bankruptcy filings by our customers.

***Environmental Accrued Liability*** – Based upon estimates prepared by our environmental engineers and consultants, we have $55.2 million accrued at December 31, 2005 to cover probable future environmental remediation expenditures. We do not believe that any of these matters, either individually or in the aggregate, will have a material adverse effect on our capital expenditures, consolidated financial condition, results of operations or cash flow beyond the amount accrued. This accrual represents our best estimate of the remaining probable remediation costs based upon information and technology currently available and our 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 we could incur additional costs in excess of the amount accrued. However, such additional costs, if any, cannot currently be estimated. Our estimate of this liability

may be revised as new regulations or technologies are developed or additional information is obtained. Changes during the past five years have primarily resulted from an increase in the estimate of future remediation costs at existing sites during 2004 and payments made each year for remediation costs that were already accrued.

For more information about our environmental liabilities, see Note N to the Consolidated Financial Statements.

***Asbestos-Related Claims*** – We have been named in various lawsuits involving multiple claimants and defendants for alleged asbestos exposure in the past by, among others, workers and contractors and their families at plants owned by us or our predecessors, or on board ships owned or operated by us or our predecessors. We have reserves totaling $0.5 million as of December 31, 2005 for asbestos-related claims that are probable and estimable. We believe that the probability is remote that losses in excess of the amounts we have accrued could be materially adverse to our financial condition, results of operations or cash flows. This belief is based upon our ongoing assessment of the strengths and weaknesses of the specific claims and our defenses and insurance coverage available for these claims, as well as the probability and expected magnitude of reasonably anticipated future asbestos-related claims. Our assessment includes: whether the pleadings allege exposure to asbestos, asbestos-containing products or premises exposure; the severity of the plaintiffs' alleged injuries from exposure to asbestos or asbestos-containing products and the length and certainty of exposure on our premises, to the extent disclosed in the pleadings or identified through discovery; whether the named defendant related to us manufactured or sold asbestos-containing products; the outcomes of cases recently resolved; and the historical pattern of the number of claims. If the underlying facts and circumstances change in the future, we will modify our reserves, as appropriate. This accrual has not materially changed over the past several years.

***Restructuring-Related Accruals*** – Since PolyOne was formed in 2000, we have recorded accruals for charges in connection with restructuring our businesses, as well as integrating acquired businesses. These accruals include estimates related to employee separation costs, the closure and/or consolidation of facilities, contractual obligations and valuing assets such as property, plant and equipment, and inventories. Actual amounts could differ from the original estimates, and have differed in the past primarily from differences between estimated and actual net proceeds received upon the sale of property, plant and equipment.

Restructuring-related accruals are reviewed on a quarterly basis and changes to plans are appropriately recognized when identified. Changes to restructuring plans for existing businesses are recorded as employee separation and plant phaseout costs in the period when the change occurs.

For more information about our restructuring activities, see Note E to the Consolidated Financial Statements.

***Goodwill*** – Under Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets," we are required to perform impairment tests of our goodwill and intangible assets. These tests must be done at least once a year, and more frequently if an event or circumstance indicates that an impairment or a decline in value may have occurred. We test for goodwill impairment on July 1 of each year. The goodwill impairment test is a two-step process, which requires us to make judgments about what assumptions to use in the calculation. The first step of the process consists of estimating the fair value of each reporting unit based on a number of factors, including projected future operating results and business plans, economic projections, anticipated future cash flows, comparable marketplace data from within a consistent industry grouping, and the cost of capital. We compare these estimated fair values with their carrying values, which includes the allocated goodwill. If the estimated fair value is less than the carrying value, a second step is performed to compute the amount of the impairment by determining an "implied fair value" of goodwill. The determination of a reporting unit's "implied fair value" of goodwill requires us to allocate the estimated fair value of the reporting unit to the assets and liabilities of the reporting unit. Any unallocated fair value represents the "implied fair value" of goodwill, which is compared to its corresponding carrying value. Subsequent to the initial impairment test upon adoption of SFAS No. 142, we have not recorded an impairment to goodwill as a result of these tests.

We cannot predict what future events might adversely affect the reported value of our goodwill. These events include, but are not limited to, strategic decisions made in response to economic competitive conditions, the impact of the economic environment on our customer base, or a material negative change in relationships with significant customers.

For more information about our goodwill, see Note D to the Consolidated Financial Statements.

***Income Taxes*** – Estimates of full year taxable income used in the tax rate calculations for the legal entities and jurisdictions in which we operate change throughout the year. During the year we use judgment to estimate our income for the year. Because judgment is involved, the tax rate may increase or decrease significantly in any period.

To determine income or loss for financial statement purposes, we make estimates and judgments. These estimates and judgments occur in the calculation of certain tax liabilities and in determining the recoverability of deferred tax assets that result from temporary differences between the tax and financial statement recognition of revenue and expense. SFAS No. 109, "Accounting for Income Taxes," also requires us to reduce the deferred tax assets by a valuation allowance if it is more likely than not that some portion or all of the recorded deferred tax assets will not be realized in future periods.

In the process of determining our ability to recover our deferred tax assets, we consider all of the available positive and negative evidence, including our past operating results, the existence of cumulative losses in recent years and our forecast of future taxable income. To estimate future taxable income we develop assumptions including the amount of future state, federal and international pre-tax income, the reversal of temporary differences and the implementation of feasible and prudent tax planning strategies. These assumptions require significant judgment to forecast future taxable income and are consistent with the plans and estimates that we use to manage our businesses.

As a result, we have computed a valuation allowance of $76.9 million, and we intend to maintain it until it is more likely than not that the related deferred tax assets will be realized. Income tax expense that we record in the future will be reduced to the extent that there are offsetting decreases in the valuation allowance. Realizing our remaining deferred tax assets depends upon our ability to execute feasible and prudent tax planning strategies. Any reduction in estimated future taxable income may require us to record an additional valuation allowance against our deferred tax assets. An increase in the valuation allowance would result in additional income tax expense in the related period and could have a significant impact on future earnings.

In addition, the calculation of tax liabilities deals with uncertainties in applying complex tax regulations in a large number of jurisdictions. We recognize potential liabilities for anticipated tax audit issues based upon our estimate of the extent to which additional taxes may be due. To the extent we prevail in matters for which accruals have been established, or are required to pay amounts in excess of recorded reserves, the effective tax rate in a given financial statement period may be materially impacted. For more information about our income taxes, see Note P to the Consolidated Financial Statements.

***Pensions and Post-retirement Benefits*** – Included in our results of operations are significant pension and post-retirement benefit costs that we measure using actuarial valuations. Inherent in these valuations are key assumptions, including assumptions about discount rates and expected returns on plan assets. These assumptions are updated at the beginning of each fiscal year. We consider current market conditions, including changes in interest rates, in making these assumptions. Changes in pension and post-retirement benefit costs may occur in the future due to changes in these assumptions.

To develop our discount rate, we consider the yields of high-quality, fixed-income investments with maturities that correspond to the timing of our benefit obligations. To develop our expected return on plan assets, we consider our historical long-term asset return experience, the expected investment portfolio mix of plan assets and an estimate of long-term investment returns. To develop our expected portfolio mix of plan assets, we consider the duration of the plan liabilities and give more weight to equity investments than to fixed-income securities. Holding all other assumptions constant, a 0.5 percentage point increase or decrease in the discount rate would have increased or decreased our 2005 net pension and post-retirement expense by approximately $1.9 million. Likewise, a 0.5 percentage point increase or decrease in the expected return on plan assets would have increased or decreased our 2005 net pension cost by approximately $1.8 million.

Market conditions and interest rates significantly affect the future assets and liabilities of our pension and post-retirement plans. It is difficult to predict these factors due to the volatility of market conditions. Holding all other assumptions constant, a 0.5 percentage point increase or decrease in the discount rate would have increased or decreased our minimum pension liability by approximately $27 million as of December 31, 2005.

The rate of increase in medical costs that we assume for the next five years was held constant with prior years to reflect both our actual experience and projected expectations. The health care cost trend rate assumption has a significant effect on the amounts reported. Only certain employees hired prior to December 31, 1999 are eligible to participate in our subsidized post-retirement plan.

For more information about our pensions and post-retirement benefits, see Note M to the Consolidated Financial Statements.

***Contingencies*** – We are subject to various investigations, claims, and legal and administrative proceedings covering a wide range of matters that arise in the ordinary course of business activities. Any liability that may result from these proceedings that we judge to be probable and estimable has been accrued. The actual amounts resulting from these matters can differ from our estimates.

***Stock Options Granted to Employees*** – On December 16, 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-Based Payment," which is a revision of SFAS No. 123, "Accounting for Stock-Based Compensation." SFAS No. 123(R) supercedes Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," and amends SFAS No. 95, "Statement of Cash Flows." The approach in SFAS No. 123(R) is similar to the approach in SFAS No. 123. However, SFAS No. 123(R) requires that all share-based payments to employees, including grants of employee stock options, be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative. We adopted Statement 123(R) in the first quarter of 2006, and currently estimate that the impact of adopting this standard will be an additional pre-tax charge in 2006 of approximately $3 million.

For more information about our stock-based compensation, see Note C to the Consolidated Financial Statements.

***New Accounting Pronouncements*** – In November 2004, the FASB issued SFAS No. 151, "Inventory Costs." SFAS No. 151 amends Accounting Research Bulletin (ARB) No. 43, Chapter 4, "Inventory Pricing," to clarify the accounting for abnormal

amounts of idle facility expense, freight, handling costs and wasted material. SFAS No. 151 requires that these items be recognized as current-period charges and requires that the allocation of fixed production overhead to the costs of conversion be based on the normal capacity of the associated production facilities. The adoption of SFAS No. 151 is effective for fiscal years beginning after June 15, 2005. The adoption of SFAS No. 151 is not expected to have a material impact on our financial position or results of operations.

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections." SFAS No. 154 applies to all voluntary changes in accounting principle and to changes that are required by an accounting pronouncement that do not include explicit transition provisions. SFAS No. 154 requires that changes in accounting principle be applied retroactively, instead of including the cumulative effect in the income statement. The correction of an error will continue to require financial statement restatement. A change in accounting estimate will continue to be accounted for in the period of change and in subsequent periods, if necessary. SFAS No. 154 is effective for fiscal years beginning after December 15, 2005. The adoption of SFAS No. 154 is not expected to have a material impact on our financial position or results of operations.

**Cash Flows**

Detail about cash flows can be found in the Consolidated Statement of Cash Flows. The following discussion focuses on the material components of cash flows from operating, investing and financing activities.

***Operating Activities*** – In 2005, our operations provided $63.7 million of cash. Primary sources of cash were: profitable business operations; a decline in inventories from improved inventory turnover that resulted from better management of inventory levels at the end of the year compared to the end of the prior year; an increase in accounts payable due to higher purchasing levels to support higher sales levels at the end of the year compared to the prior year; cash distributions that we received from our equity investments; and short-term borrowings under our receivables sale facility. Primary uses of cash were: cash payments for environmental remediation at inactive sites; an increase in accounts receivable due to higher sales levels at the end of the year compared to the prior year; and the payment of employee bonuses that had been accrued at the end of 2004 that were greater than those that were accrued at the end of 2005. Cash provided by discontinued operations was $1.6 million.

In 2004, our operations used $21.9 million of cash. Primary sources of cash were: profitable business operations; an increase in accounts payable due to a higher purchasing levels to support higher sales levels at the end of the year compared to the prior year, combined with longer payment terms; and cash distributions that we received from our equity investments. Primary uses of cash were: cash payments for employee separation and plant closure initiatives; an increase in accounts receivable due to higher sales levels at the end of the year compared to the prior year; the repayment of short-term borrowings under our receivables sale facility; and a $65 million voluntary contribution to our defined-benefit pension plans. Cash provided by discontinued operations was $13.4 million.

In 2003, our operations used $169.4 million of cash. Primary sources of cash were cash distributions that we received from our equity investments and a decline in inventories from improved inventory turnover that resulted from better management of inventory levels at the end of the year compared to the end of the prior year. Primary uses of cash were: a net loss in 2003; cash payments for employee separation and plant closure initiatives; a decline in accounts payable due to the timing of payments at the end of the year compared to the end of the prior year; the repayment of short-term borrowings under our receivables sale facility; and a decline in accrued pension costs. Cash provided by discontinued operations was $19.9 million.

***Working capital management***

Our working capital management efforts focus on three components of working capital that we believe are the most critical to maximizing cash provided by operating activities that we can manage on a day-to-day basis. These components are accounts receivable, inventories and accounts payable. To help us manage working capital, we use metrics that measure the number of days of sales in receivables (DSO), inventories (DSI) and accounts payable (DSP). This allows us to better understand the total dollar changes in these components of working capital by separating the changes due to efficiency (days outstanding) and the underlying volume of business (sales and production levels).

The following table presents our working capital metrics and the impact of changes in efficiency and volume on accounts receivable, inventories and accounts payable:

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| Accounts receivable DSO | 50.1 | 53.8 | 54.3 |
| Inventories DSI | 41.3 | 46.9 | 49.2 |
| Accounts payable DSP | (40.2) | (43.4) | (39.3) |
| Net days at year end | 51.2 | 57.3 | 64.2 |
| Change in net days from prior year end | (6.1) | (6.9) | |
| Cash provided (used) by | | | |
| (In millions) | | | |
| Accounts receivable | $(23.6) | $(21.7) | |
| Inventories | 9.3 | 1.5 | |
| Accounts payable | 13.0 | 22.2 | |
| | $ (1.3) | $ 2.0 | |
| Impact of change in days outstanding | $ 33.9 | $ 31.9 | |
| Impact of change in sales and production levels | (35.2) | (29.9) | |
| | $ (1.3) | $ 2.0 | |

Higher sales levels during 2004 and 2005 used $65.1 million of cash from operating activities to fund the increase in sales from 2003 to 2005. Effective working capital reduction programs, however, resulted in a decline of 13 net days outstanding over the same time period. This contributed $65.8 million to cash provided by operating activities, holding the increase in our total investment in receivables, inventory and payables from the effect of higher sales levels to a minimum since December 31, 2003.

***Investing Activities*** – In 2005, we used $24.2 million for investing activities, reflecting capital spending in support of manufacturing operations, the purchase of the remaining 16% of Star Color, a Thailand-based color and additives business, and the purchase of certain assets of Novatec Plastics Corporation. These two businesses are included in our Performance Plastics segment. This was partially offset by proceeds that we received from the sale of previously closed facilities. Capital spending as a percentage of depreciation was 67% in 2005. Cash used by discontinued operations was $1.7 million.

In 2004, we generated $106.8 million from investing activities, largely from the sale of our Elastomers and Performance Additives business and our European Melos rubber granules business. Melos was formerly included in our Performance Plastics segment. Elastomers and Performance Additives was a separate business segment. This was partially offset by capital spending in support of manufacturing operations and the acquisition of the North American distribution business of ResinDirect LLC, which is included in our Distribution segment. Capital spending as a percentage of depreciation in 2004 was 51%. Cash used by discontinued operations was $4.6 million.

In 2003, we used $19.0 million from investing activities, driven by capital spending in support of manufacturing operations and the final payment due on our December 2002 acquisition of Transformacion de Pigmentos Y Colorantes, S.A., which is included in our Performance Plastics segment. This was partially offset by proceeds we received from the sale of our 51% interest in Techmer P.M., LLC, which was formerly included in our Performance Plastics segment. Cash used by discontinued operations was $5.4 million.

***Financing Activities*** – Cash used by financing activities in 2005 and 2004 was primarily to reduce debt. Cash provided by financing activities in 2003 was primarily from the issuance of $300 million of 10.625% unsecured notes, partially offset by the maturity of $88 million of 9.375% senior notes.

***Discontinued Operations*** – Cash flows from discontinued operations are presented separately on a single line in each section of the Consolidated Statement of Cash Flows. The absence of future cash flows from discontinued operations is not expected to materially affect future liquidity and capital resources. We do expect, however, that retaining the Specialty Resins business that was previously reported as a discontinued operation will positively affect our future liquidity and capital resources.

**Balance Sheets**

The following discussion focuses on material changes in balance sheet line items from December 31, 2004 to December 31, 2005 that are not discussed in the preceding "Cash Flows" section.

*Other current assets* – The increase was primarily due to recording a receivable for a fourth quarter 2005 legal settlement. The funds were received in the first quarter of 2006.

*Property, net* – The reduction was primarily due to the sale of redundant assets, a decline in currency exchange rates and capital spending that was less than depreciation expense.

*Post-retirement benefits other than pensions* – The reduction was primarily due to the payment of other post-employment benefits (OPEBs) that were in excess of the amount expensed and added to the accrual.

*Other non-current liabilities including pensions* – The reduction was primarily due to cash payments for environmental remediation costs that were in excess of the amount expensed and added to the accrual.

**Capital Resources and Liquidity**

Liquidity is defined as an enterprise's ability to generate adequate amounts of cash to meet both current and future needs. These needs include paying obligations as they mature, maintaining production capacity and providing for planned growth. Capital re-

sources are sources of funds other than those generated by operations. We are not aware of any trends, demands, commitments, events, or uncertainties that are reasonably likely to result in our liquidity increasing or decreasing in any material way, other than the following:

- we received a cash payment of $20.5 million in February 2006 upon the sale of the Engineered Films business;
- we anticipate receiving proceeds of approximately $15 million to $25 million from various legal matters including insurance coverage and antitrust claims, which were settled in our favor in the fourth quarter of 2005 and first quarter of 2006; and
- we anticipate receiving gross proceeds of approximately $5 million to $10 million from the sale of previously closed facilities and redundant assets in 2006.

As of December 31, 2005, we had existing facilities to access available capital resources (receivables sale facility, secured revolving credit facility, uncommitted short-term credit lines and senior unsecured notes and debentures) totaling $812.2 million. As of December 31, 2005, we had used $654.4 million of these facilities, and $157.8 million was available to be drawn while remaining in compliance with all facilities. The following table summarizes our available and outstanding facilities at December 31, 2005:

| (In millions) | Outstanding | Available |
|---|---|---|
| Long-term debt | $639.4 | $ — |
| Revolving credit facility | — | 13.8 |
| Receivables sale facility | 7.9 | 144.0 |
| Short-term bank debt | 7.1 | — |
| | $654.4 | $157.8 |

***Long-Term Debt*** – At December 31, 2005, long-term debt totaled $639.4 million, with maturities ranging from 2006 to 2015. Current maturities of long-term debt at December 31, 2005 were $0.7 million. For more information about our debt, see Note G to the Consolidated Financial Statements.

***Revolving Credit Facility*** – On July 26, 2005, we amended our revolving credit facility to modify the financial covenants. We are required to maintain certain Interest Coverage and Borrowed Debt-to-Adjusted EBITDA ratios, which are defined in the agreement that governs the facility. The revolving credit facility also limits the amount of payments we can make for capital expenditures, acquisitions and dividends. Under the terms of the agreement, we must maintain a minimum Interest Coverage Ratio of 2.0 each quarter and a maximum Borrowed Debt-to-Adjusted EBITDA of 4.65 as of December 31, 2005 and 4.5 thereafter. As of December 31, 2005, the Interest Coverage Ratio was 2.65 and the Borrowed Debt-to-Adjusted EBITDA Ratio was 3.73. Based on projected operating results, we expect to remain in compliance with these financial covenants through the expiration date of this agreement.

The revolving credit facility has a three-year term that expires in May 2006 and provides up to $30 million in borrowings and for issuing standby letters of credit. In anticipation of the maturity of this facility, we will begin negotiations in the near future to either restructure this facility or extend the maturity date. We do not anticipate any difficulties in this process. Obligations under the revolving credit facility are secured by substantially all of our domestic intellectual property and inventory, and some of our domestic real property. As of December 31, 2005, we had not drawn on the revolving credit facility, although it served as a back-up facility for $6.0 million of outstanding letters of credit and $5.0 million of loan guarantees.

***Receivables Sale Facility*** – On July 26, 2005, we amended our receivables sale facility to extend the expiration date to July 2010, to reduce the cost of utilizing the facility and to modify a financial covenant. Our receivables sale facility allows us to sell accounts receivable and obtain proceeds of up to $175.0 million. The maximum proceeds that we may receive is limited to 85% of the eligible domestic accounts receivable sold. This facility also makes up to $40.0 million available for issuing standby letters of credit, of which $13.0 million was used at December 31, 2005.

The amended 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 availability under the facility is $40 million or less. As of December 31, 2005, the Fixed Charge Coverage Ratio was 1.8 to 1 and availability under the facility was $144.0 million.

The amount of eligible receivables that are available to be sold under the facility was affected by the divestment of the Engineered Films business that was sold in February 2006. This business historically sold its receivables under the facility. The amount of receivables as of December 31, 2005 for the Engineered Films business included in the eligible receivables available to be sold under the facility was $13.4 million.

Of the capital resource facilities available to us as of December 31, 2005, the portion of the receivables sale facility that was actually 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 December 31, 2005, we had sold accounts receivable of $7.9 million and had guaranteed $73.1 million of our SunBelt equity affiliate's debt.

The following table summarizes our obligations under long-term debt, operating leases, standby letters of credit, interest obligations, pension and post-retirement obligations, guarantees and purchase obligations as of December 31, 2005:

| | Payment Due by Period | | | | |
|---|---|---|---|---|---|
| (In millions) | Total | Less than 1 Year | 1-3 Years | 4-5 Years | More than 5 Years |
| Long-term debt | $ 639.4 | $ 0.7 | $ 37.8 | $335.1 | $265.8 |
| Operating leases | 63.7 | 14.9 | 20.8 | 13.4 | 14.6 |
| Standby letters of credit | 19.0 | 19.0 | — | — | — |
| Interest obligations(1) | 315.5 | 60.2 | 117.7 | 93.5 | 44.1 |
| Pension and post-retirement obligations(2) | 443.0 | 43.4 | 87.2 | 88.3 | 224.1 |
| Guarantees | 73.1 | 6.1 | 12.2 | 12.2 | 42.6 |
| Purchase obligations | 1.8 | 1.1 | 0.4 | 0.3 | — |
| Total | $1,555.5 | $145.4 | $276.1 | $542.8 | $591.2 |

(1) Interest obligations are stated at the rate of interest that is defined by the debt instrument and take into effect any impact of rate swap agreements, assuming that the debt is paid at maturity.
(2) Pension and post-retirement obligations relate to our U.S. and international pension and other post-retirement plans. There are no minimum funding requirements in 2006 for our U.S. qualified defined benefit pension plans. Obligations are based on the plans' current funded status and actuarial assumptions, and include projected benefit payments to participants through 2015.

We expect that profitable operations in 2006 will enable us to maintain existing levels of available capital resources and meet our cash requirements. Expected sources of cash in 2006 include net income, borrowings under existing loan agreements, cash distributions from equity affiliates, proceeds from the settlement of legal issues, proceeds from the sale of previously closed facilities and redundant assets, and $20.5 million of proceeds from the sale of the Engineered Films business. Expected uses of cash in 2006 include interest expense and discounts on the sale of accounts receivable totaling approximately $60 million, cash taxes and capital expenditures. Capital expenditures are currently estimated to be between $45 and $50 million in 2006, primarily to support manufacturing operations and growth initiatives. Cash expenditures for environmental remediation in future years are expected to be consistent with 2005 levels. We may also repurchase or repay additional long-term debt in 2006 as part of our strategy to reduce debt.

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 revolving credit and receivables sale facilities, should allow us to maintain adequate levels of available capital resources to fund our operations and meet debt service and minimum pension funding requirements for both the short- and long-term.

**Related-Party Transactions**

We purchase a substantial portion of our PVC resin and all of our VCM raw materials under supply agreements with OxyVinyls, a 24% equity-owned company. These agreements have an initial term of 15 years, commencing May 1, 1999, and we have the right to renew these agreements for two five-year periods. We have also entered into various service agreements with OxyVinyls. Net amounts owed to OxyVinyls, primarily for raw material purchases, totaled $28.0 million at December 31, 2005 and $22.5 million at December 31, 2004. Our total purchases of raw materials from OxyVinyls were $352 million during 2005 and $264 million during 2004.

**Off-Balance Sheet Arrangements**

***Receivables Sale facility*** – We sell our accounts receivable to PolyOne Funding Corporation (PFC), a wholly-owned, bankruptcy-remote subsidiary. At December 31, 2005, accounts receivable totaling $195.2 million were sold to PFC and, as a result, are reflected as a reduction of accounts receivable in our Consolidated Balance Sheets. PFC in turn sells an undivided interest in these accounts receivable to certain investors and realizes proceeds of up to $175 million. The maximum proceeds that PFC may receive under the facility is limited to 85% of the eligible accounts receivable sold to PFC. At December 31, 2005, PFC had sold $7.9 million of its undivided interests in accounts receivable. We retained an interest in the $187.3 million difference between the amount of trade receivables sold by us to PFC and the undivided interests sold by PFC. As a result, this retained interest is included in accounts receivable on our Consolidated Balance Sheet at December 31, 2005. For more information about our receivables sale facility, see Note I to the Consolidated Financial Statements.

***Guarantee of indebtedness of others*** – As discussed in Note N to the Consolidated Financial Statements, we guarantee $73.1 million of unconsolidated equity affiliate debt of Sunbelt in connection with the construction of a chlor-alkali facility in Macintosh, Alabama. This debt guarantee matures in 2017.

***Letters of credit*** – We maintain approximately $6.0 million of letters of credit under the revolving credit facility and approximately $13.0 million letters of credit under the receivables sale facility. These letters of credit are issued by our bank in favor of third parties and are mainly related to insurance claims and interest rate swap agreements.

We have no other off-balance sheet arrangements as defined in Item 303(a)(4)(ii) of Regulation S-K.

**CAUTIONARY NOTE ON FORWARD-LOOKING STATEMENTS**

In this annual report on Form 10-K, 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. You can identify these statements by the fact that they do not relate strictly to historic or current facts. They use words such as “anticipate,” “estimate,” “expect,” “project,” “intend,” “plan,” “believe” and other words and terms of similar meaning in connection with any discussion of future operating or financial performance. In particular, these include statements relating to future actions; prospective changes in raw material costs, product pricing or product demand; future performance or results of current and anticipated market conditions and market strategies; sales efforts; expenses; the outcome of contingencies such as legal proceedings; and financial results. Factors that could cause actual results to differ materially include, but are not limited to:

- the effect on foreign operations of currency fluctuations, tariffs, nationalization, exchange controls, limitations on foreign investment in local businesses and other political, economic and regulatory risks;
- changes in U.S., regional or world polymer consumption growth rates affecting PolyOne’s markets;
- changes in global industry capacity or in the rate at which anticipated changes in industry capacity come online in the PVC, chlor-alkali, VCM or other industries in which PolyOne participates;
- fluctuations in raw material prices, quality and supply and in energy prices and supply, in particular fluctuations outside the normal range of industry cycles, including those related to the effects of Hurricane Katrina and Rita;
- production outages or material costs associated with scheduled or unscheduled maintenance programs;
- costs or difficulties and delays related to the operation of joint venture entities;
- lack of day-to-day operating control, including procurement of raw materials, of equity or joint venture affiliates;
- partial control over investment decisions and dividend distribution policy of the OxyVinyls partnership and other minority equity holdings of PolyOne;
- an inability to launch new products and/or services within PolyOne’s various businesses;
- the possibility of further goodwill impairment;
- an inability to maintain any required licenses or permits;
- an inability to comply with any environmental laws and regulations;
- the cost of compliance with environmental laws and regulations, including any increased cost of complying with new or revised laws and regulations;
- 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 cost reductions and employee productivity goals;
- a delay or inability to achieve targeted debt level reductions through divestitures and/or other means;
- an inability to access the revolving credit facility and/or the receivables sale facility as a result of breaching covenants due to not achieving anticipated earnings performance or for any other reason;
- any poor performance of the pension plan assets and any obligation to fund PolyOne’s pension plan;
- any delay and/or inability to bring the North American Color, North American Engineered Materials and newly-formed Producer Services product groups to profitability;
- an inability to raise prices or sustain price increases for products;
- an inability to achieve anticipated earnings performance due to the divestment of a non-core business;
- an ability to maintain appropriate relations with unions and employees in certain locations in order to avoid disruptions of business
- other factors affecting PolyOne’s business beyond its control, including, without limitation, changes in the general economy, changes in interest rates and changes in the rate of inflation; and
- other factors described in this Annual Report under Item 1A, “Risk Factors.”

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. 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.

Table of Contents

## ITEM 7A. QUANTITATIVE AND QUALITATIVE INFORMATION ABOUT MARKET RISK

We are exposed to certain market risks as part of our ongoing business operations, including risks from changes in interest rates on debt obligations and foreign currency exchange rates that could impact our financial condition, results of operations and cash flows. We manage our exposure to these and other market risks through regular operating and financing activities, including the use of derivative financial instruments. We intend to use these derivative financial instruments as risk management tools and not for speculative investment purposes.

***Interest rate exposure*** – We periodically enter into interest rate swap agreements that modify our exposure to interest risk by converting our fixed-rate obligations to floating rates. On September 3, 2004, we terminated one of our seven existing interest rate swap agreements at a cash cost of $0.3 million. The six remaining agreements had a net fair value obligation of negative $5.8 million and negative $3.6 million at December 31, 2005 and 2004, respectively. The weighted-average interest rate for these six agreements was 8.2% at December 31, 2005 and 6.1% at December 31, 2004. These exchange agreements are perfectly effective as defined by SFAS No. 133, “Accounting for Derivative Financial Instruments and Hedging Activities.” There have been no material changes in the market risk we faced during 2005. For more information about our interest rate exposure, see Note C to the Consolidated Financial Statements.

***Foreign currency exposure*** – We enter into intercompany lending transactions that are denominated in various foreign currencies and are subject to financial exposure from foreign exchange rate movement from the date a loan is recorded to the date it is settled or revalued. To mitigate this risk, we enter into foreign exchange contracts. Gains and losses on these contracts generally offset gains or losses on the assets and liabilities being hedged, and are recorded as other income or expense in the Consolidated Statements of Operations. We do not hold or issue financial instruments for trading purposes. For more information about our foreign currency exposure, see Note T to the Consolidated Financial Statements.

## ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

**Index to Financial Statements and Financial Statement Schedule**


| | Page |
|---|---|
| Management’s Report | 31 |
| Reports of Independent Registered Public Accounting Firm | 32 |
| Consolidated Financial Statements: | |
| Consolidated Statements of Operations | 33 |
| Consolidated Balance Sheets | 34 |
| Consolidated Statements of Cash Flows | 35 |
| Consolidated Statements of Shareholders’ Equity | 36 |
| Notes to Consolidated Financial Statements | 37-61 |
| Financial Statement Schedules: | |
| Schedule II – Valuation and Qualifying Accounts | 62 |


## MANAGEMENT’S REPORT

The management of PolyOne Corporation is responsible for preparing the consolidated financial statements and disclosures included in this annual report. The financial statements and disclosures included in this annual report fairly present in all material respects the financial position, results of operations, shareholders’ equity and cash flows of PolyOne Corporation as of and for the year ended December 31, 2005.

Management is responsible for establishing and maintaining disclosure controls and procedures designed to ensure that the information required to be disclosed by the company is captured and reported in a timely manner. Management has evaluated the design and operation of the company’s disclosure controls and procedures at December 31, 2005, and found them to be effective.

Management is also responsible for establishing and maintaining a system of internal control over financial reporting that is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Internal control over financial reporting includes policies and procedures that provide reasonable assurance that: PolyOne Corporation’s accounting records accurately and fairly reflect the transactions and dispositions of the assets of the company; unauthorized or improper acquisition, use or disposal of company assets will be prevented or timely detected; the company’s transactions are properly recorded and reported to permit the preparation of the company’s financial statements in conformity with generally accepted accounting principles; and the company’s receipts and expenditures are made only in accordance with authorizations of management and the board of directors of the company.

Management has assessed the effectiveness of PolyOne’s internal control over financial reporting as of December 31, 2005, and has prepared Management’s Annual Report On Internal Control Over Financial Reporting contained on page 62 of this annual report. This report concludes that internal control over financial reporting is effective and that no material weaknesses were identified.

Ernst & Young, who audited the consolidated financial statements of PolyOne Corporation as of and for the year ended December 31, 2005, also audited management’s assessment of internal control over financial reporting and issued an attestation report on that assessment.

| /s/ Stephen D. Newlin | /s/ W. David Wilson |
|---|---|
| Stephen D. Newlin<br>President and<br>Chief Executive Officer | W. David Wilson<br>Vice President<br>and Chief Financial Officer |

February 24, 2006

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

**The Board of Directors and Shareholders PolyOne Corporation**

We have audited management's assessment, included in Item 9A,"Controls and Procedures — Management's Annual Report on Internal Control over Financial Reporting," that PolyOne Corporation maintained effective internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control — Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). PolyOne Corporation's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control over financial reporting, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that: (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that PolyOne Corporation maintained effective internal control over financial reporting as of December 31, 2005 is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, PolyOne Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2005, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of PolyOne Corporation and subsidiaries as of December 31, 2005, and 2004, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2005 of PolyOne Corporation and our report dated February 24, 2006 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG

Cleveland, Ohio
February 24, 2006

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

**To the Board of Directors and Shareholders PolyOne Corporation**

We have audited the consolidated balance sheets of PolyOne Corporation and subsidiaries as of December 31, 2005 and 2004, and the related consolidated statements of operations, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 2005. Our audits also included the financial statement schedule listed in the Index at Item 15(a)(2). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits. The financial statements of Oxy Vinyls, LP (a limited partnership in which the Company has a 24% interest) have been audited by other auditors whose report has been furnished to us, and our opinion on the consolidated financial statements, insofar as it relates to 2005, 2004 and 2003 amounts included for Oxy Vinyls, LP, is based solely on the report of the other auditors.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits and the report of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of PolyOne Corporation and subsidiaries at December 31, 2005 and 2004, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 2005, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of December 31, 2005, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 24, 2006 expressed an unqualified opinion thereon.

/s/ ERNST & YOUNG

Cleveland, Ohio
February 24, 2006

## Consolidated Statements of Operations

| (In millions, except per share data) | Year Ended December 31, 2005 | 2004 | 2003 |
|---|---|---|---|
| Sales | $2,450.6 | $2,267.7 | $2,048.1 |
| Operating costs and expenses: | | | |
| Cost of sales | 2,153.5 | 1,934.2 | 1,736.9 |
| Selling and administrative | 178.2 | 201.9 | 244.8 |
| Depreciation and amortization | 50.7 | 50.9 | 57.7 |
| Employee separation and plant phaseout | 5.5 | (1.4) | 35.7 |
| Asset impairments | 0.4 | 3.8 | 19.4 |
| Environmental remediation at inactive sites | 0.9 | 8.7 | 2.7 |
| Loss on sale of assets | — | 5.9 | 0.3 |
| Income from equity affiliates and minority interest | (78.9) | (64.7) | (34.5) |
| Operating income (loss) | 140.3 | 128.4 | (14.9) |
| Interest expense | (68.1) | (72.1) | (66.6) |
| Interest income | 1.9 | 1.5 | 0.9 |
| Other expense, net | (5.3) | (16.5) | (13.3) |
| Income (loss) before income taxes and discontinued operations | 68.8 | 41.3 | (93.9) |
| Income tax expense | (6.6) | (13.7) | (12.5) |
| Income (loss) before discontinued operations | 62.2 | 27.6 | (106.4) |
| Loss from discontinued operations and loss on sale, net of income taxes | (15.3) | (4.1) | (144.7) |
| Net income (loss) | $ 46.9 | $ 23.5 | $ (251.1) |
| Earnings (loss) per common share: | | | |
| Basic and diluted earnings (loss): | | | |
| Before discontinued operations | $ 0.68 | $ 0.30 | $ (1.17) |
| Discontinued operations | (0.17) | (0.04) | (1.59) |
| Basic and diluted earnings (loss) per share | $ 0.51 | $ 0.26 | $ (2.76) |
| Weighted average shares used to compute earnings per share: | | | |
| Basic | 91.9 | 91.6 | 91.1 |
| Diluted | 92.0 | 91.8 | 91.1 |

See Notes to Consolidated Financial Statements.

# Consolidated Balance Sheets

| (In millions, except per share data) | December 31, 2005 | 2004 |
|---|---|---|
| **ASSETS** | | |
| **Current assets** | | |
| Cash and cash equivalents | $ 32.8 | $ 38.6 |
| Accounts receivable (less allowance of $6.4 in 2005 and $8.0 in 2004) | 320.5 | 312.9 |
| Inventories | 191.8 | 205.3 |
| Deferred income tax assets | 20.1 | 20.1 |
| Other current assets | 27.4 | 19.5 |
| Discontinued operations | 20.9 | 23.3 |
| **Total current assets** | 613.5 | 619.7 |
| Property, net | 436.0 | 478.9 |
| Investment in equity affiliates | 273.9 | 263.3 |
| Goodwill, net | 315.3 | 321.0 |
| Other intangible assets, net | 10.6 | 10.1 |
| Other non-current assets | 60.0 | 59.7 |
| Discontinued operations | 6.7 | 22.1 |
| **Total assets** | $1,716.0 | $1,774.8 |
| **LIABILITIES AND SHAREHOLDERS' EQUITY** | | |
| **Current liabilities** | | |
| Short-term bank debt | $ 7.1 | $ 2.3 |
| Accounts payable, including amounts payable to related party (see Note N) | 232.6 | 225.1 |
| Accrued expenses | 82.4 | 109.0 |
| Current portion of long-term debt | 0.7 | 49.3 |
| Discontinued operations | 11.2 | 13.8 |
| **Total current liabilities** | 334.0 | 399.5 |
| Long-term debt | 638.7 | 640.5 |
| Post-retirement benefits other than pensions | 107.9 | 113.9 |
| Other non-current liabilities including pensions | 214.3 | 233.7 |
| Minority interest in consolidated subsidiaries | 5.4 | 6.8 |
| **Total liabilities** | 1,300.3 | 1,394.4 |
| **Commitments and Contingencies (see Note N)** | | |
| **Shareholders' equity** | | |
| Preferred stock, 40.0 shares authorized, no shares issued | — | — |
| Common stock, $0.01 par, 400.0 shares authorized, 122.2 shares issued in 2005 and 2004 | 1.2 | 1.2 |
| Additional paid-in capital | 1,066.4 | 1,067.2 |
| Retained deficit | (162.0) | (208.9) |
| Common stock held in treasury, 30.3 shares in 2005 and 30.5 shares in 2004 | (337.1) | (339.0) |
| Accumulated other comprehensive loss | (152.8) | (140.1) |
| **Total shareholders' equity** | 415.7 | 380.4 |
| **Total liabilities and shareholders' equity** | $1,716.0 | $1,774.8 |

See Notes to Consolidated Financial Statements.

# Consolidated Statements of Cash Flows

| (In millions) | 2005 | Year Ended December 31, 2004 (revised – see note C) | 2003 (revised – see note C) |
|---|---|---|---|
| **Operating activities** | | | |
| Net income (loss) | $ 46.9 | $ 23.5 | $(251.1) |
| Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities: | | | |
| Employee separation and plant phaseout charge (benefit) | 5.5 | (1.4) | 35.7 |
| Cash payments for employee separation and plant phaseout | (3.6) | (23.3) | (39.0) |
| Asset impairment charges | 0.4 | 3.8 | 19.4 |
| Charges for environmental remediation at inactive sites | 0.9 | 8.7 | 2.7 |
| Cash payments for environmental remediation at inactive sites | (8.7) | (1.6) | (2.8) |
| Depreciation and amortization | 50.7 | 50.9 | 57.7 |
| Loss on sale of assets | — | 5.9 | 0.3 |
| Loss on disposition of discontinued businesses and related plant phaseout charge | 15.6 | 28.8 | 144.9 |
| Companies carried at equity and minority interest: | | | |
| Income from equity affiliates | (78.9) | (64.7) | (34.5) |
| Dividends and distributions received | 67.4 | 51.5 | 24.7 |
| Provision for deferred income taxes | 2.0 | 0.7 | 4.7 |
| Changes in assets and liabilities: | | | |
| Accounts receivable | (23.6) | (21.7) | 5.5 |
| Inventories | 9.3 | 1.5 | 25.3 |
| Accounts payable | 13.0 | 22.2 | (29.9) |
| Increase (decrease) in sale of accounts receivable | 7.9 | (70.7) | (89.2) |
| Accrued expenses and other | (42.9) | (41.9) | (50.5) |
| Net cash provided by discontinued operations | 1.8 | 5.9 | 6.7 |
| **Net cash provided (used) by operating activities** | 63.7 | (21.9) | (169.4) |
| **Investing activities** | | | |
| Capital expenditures | (32.1) | (23.9) | (29.4) |
| Return of capital by equity affiliates, net | — | 8.3 | 3.9 |
| Business acquisitions, net of cash acquired | (2.7) | (6.7) | (15.8) |
| Proceeds from sale of discontinued business, net | — | 101.5 | — |
| Proceeds from sale of assets | 12.3 | 32.2 | 27.7 |
| Net cash used by discontinued operations | (1.7) | (4.6) | (5.4) |
| **Net cash provided (used) by investing activities** | (24.2) | 106.8 | (19.0) |
| **Financing activities** | | | |
| Change in short-term debt | 4.8 | 1.2 | 0.4 |
| Repayment of long-term debt | (49.0) | (94.9) | (90.1) |
| Issuance of long-term debt | — | — | 300.0 |
| Debt issuance costs | — | (0.4) | (15.0) |
| Termination of interest rate swap agreements | — | (0.3) | (2.6) |
| Proceeds from the exercise of stock options | 0.5 | 0.3 | — |
| **Net cash provided (used) by financing activities** | (43.7) | (94.1) | 192.7 |
| **Effect of exchange rate changes on cash** | (1.6) | (0.9) | 3.0 |
| **Increase (decrease) in cash and cash equivalents** | (5.8) | (10.1) | 7.3 |
| Cash and cash equivalents at beginning of year | 38.6 | 48.7 | 41.4 |
| **Cash and cash equivalents at end of year** | $ 32.8 | $ 38.6 | $ 48.7 |

See Notes to Consolidated Financial Statements.

# Consolidated Statements of Shareholders' Equity

| (In millions, except per share data; shares in thousands) | Common Shares | Common Shares Held in Treasury | Total | Common Stock | Additional Paid-In Capital | Retained Earnings (Deficit) | Common Stock Held in Treasury | Share Ownership Trust | Accumulated Other Comprehensive Income (Loss) |
|---|---|---|---|---|---|---|---|---|---|
| Balance December 31, 2002 | 122,192 | 30,517 | $ 579.7 | $1.2 | $1,069.5 | $ 18.7 | $(341.1) | $(1.8) | $(166.8) |
| Comprehensive income (loss): | | | | | | | | | |
| Net loss | | | (251.1) | | | (251.1) | | | |
| Translation adjustment | | | 26.7 | | | | | | 26.7 |
| Adjustment of minimum pension liability, net of tax | | | 9.1 | | | | | | 9.1 |
| Total comprehensive loss: | | | (215.3) | | | | | | |
| Stock-based compensation and benefits and exercise of options | | (92) | 2.4 | | (0.9) | | 1.3 | 0.6 | 1.4 |
| Adjustment to market value | | | — | | 0.1 | | | (0.1) | |
| Balance December 31, 2003 | 122,192 | 30,425 | $ 366.8 | $1.2 | $1,068.7 | $(232.4) | $(339.8) | $(1.3) | $(129.6) |
| Comprehensive income: | | | | | | | | | |
| Net income | | | 23.5 | | | 23.5 | | | |
| Translation adjustment | | | 7.9 | | | | | | 7.9 |
| Adjustment of minimum pension liability, net of tax | | | (19.9) | | | | | | (19.9) |
| Total comprehensive income: | | | 11.5 | | | | | | |
| Stock-based compensation and benefits and exercise of options | | 55 | 2.1 | | (1.5) | | 0.8 | 1.3 | 1.5 |
| Balance December 31, 2004 | 122,192 | 30,480 | $ 380.4 | $1.2 | $1,067.2 | $(208.9) | $(339.0) | $ — | $(140.1) |
| Comprehensive income: | | | | | | | | | |
| Net income | | | 46.9 | | | 46.9 | | | |
| Translation adjustment | | | (9.3) | | | | | | (9.3) |
| Adjustment of minimum pension liability, net of tax | | | (2.4) | | | | | | (2.4) |
| Total comprehensive income: | | | 35.2 | | | | | | |
| Stock-based compensation and benefits and exercise of options | | (225) | 0.1 | | (0.8) | | 1.9 | | (1.0) |
| Balance December 31, 2005 | 122,192 | 30,255 | $ 415.7 | $1.2 | $1,066.4 | $(162.0) | $(337.1) | $ — | $(152.8) |

See Notes to Consolidated Financial Statements.

**Notes to Consolidated Financial Statements**

**Note A – DESCRIPTION OF BUSINESS**

PolyOne Corporation (PolyOne or Company) is an international polymer services company with operations in thermoplastic compounds, specialty polyvinyl chloride (PVC) vinyl resins, specialty polymer formulations, color and additive systems, and thermoplastic resin distribution. PolyOne also has equity investments in manufacturers of PVC resin and its intermediates. PolyOne was formed on August 31, 2000 as a result of the consolidation of The Geon Company (Geon) and M.A. Hanna Company (Hanna).

PolyOne's operations are located primarily in the United States, Europe, Canada, Asia and Mexico. PolyOne operates in three segments: Performance Plastics, Distribution, and Resin and Intermediates. See Note R for more information.

PolyOne sold its Elastomers and Performance Additives business in August 2004 and its Engineered Films business in February 2006. Elastomers and Performance Additives was a separate segment, and Engineered Films was previously included in the Performance Plastics segment. All historical information for these businesses is presented as discontinued operations. Unless otherwise noted, the disclosures in these financial statements pertain to PolyOne's continuing operations. See Note B for more information.

**Note B – DISCONTINUED OPERATIONS**

In October 2003, PolyOne announced that its future focus would be on its global Plastics Compounding, Color & Additive Masterbatch and Distribution businesses to improve profitability and strengthen its balance sheet because management believes these businesses have the strongest market synergies and potential for long-term success. Consequently, the Elastomers and Performance Additives, Engineered Films and Specialty Resins businesses were targeted for divestment. In December 2003, PolyOne's board of directors authorized management to complete and execute plans to sell these businesses. The Elastomers and Performance Additives business was a separate segment and the Specialty Resins and Engineered Films businesses were included in the Performance Plastics segment.

As a result, these businesses qualified for accounting treatment as discontinued operations as of December 31, 2003 under Statement of Financial Accounting Standards (SFAS) No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." Accordingly, 2003 revenues, costs and expenses, assets and liabilities, and cash flows of these businesses were segregated in the Consolidated Statements of Operations, Consolidated Balance Sheets and Consolidated Statements of Cash Flows.

The net assets held for sale of these businesses were written down to their projected net sale proceeds at December 31, 2003. The resulting charges were $92.6 million for the Elastomers and Performance Additives business, $26.5 million for the Engineered Films business and $11.4 million for the Specialty Resins business. These charges were included in "Income (loss) from discontinued operations and loss on sale, net of income taxes" in the Consolidated Statement of Operations for the year ended December 31, 2003 as reported in PolyOne's Annual Report on Form 10-K for the year ended December 31, 2003.

In August 2004, PolyOne sold the Elastomers and Performance Additives business to an entity formed by an investor group led by Lion Chemical Capital, LLC and ACI Capital Co., Inc. for gross proceeds of $120 million before associated fees and costs. A cash payment of $106 million was made on the closing date and the remaining $14 million was in the form of a six-year note from the buyer. Consequently, PolyOne recognized a $17.0 million non-cash pre-tax charge to adjust the net asset carrying value of the Elastomers and Performance Additives business on the date of sale to the net proceeds received. In the fourth quarter of 2004, PolyOne also recorded a $4.3 million charge to reduce the net carrying value of the net assets held for sale of the Engineered Films business to reflect management's best estimate of the projected net sale proceeds. These charges are included in "Loss from discontinued operations and loss on sale, net of income taxes" in the Consolidated Statement of Operations for the year ended December 31, 2004.

In December 2005, PolyOne announced that the Specialty Resins divestment process was unlikely to result in a sale of the business at acceptable terms. As a result, its financial results were reclassified from discontinued operations to continuing operations. The $11.4 million write-down of Specialty Resins' net assets in 2003 is now included as an impairment loss in 2003 following the reclassification of Specialty Resins to continuing operations for all historic periods presented as of December 31, 2005. No adjustments to the carrying value were required when it was reclassified to continuing operations. Specialty Resins is now included in the Performance Plastics segment, where it had been previously.

Also in 2005, PolyOne recorded additional charges of $15.1 million to further reduce the net assets held for sale of the Engineered Films business to reflect its net realizable value based upon current estimates.

On February 15, 2006, PolyOne sold 82% of the Engineered Films business to an investor group consisting of members of the business unit's management team and Matrix Films, LLC for gross proceeds of $26.7 million before associated fees and costs. A cash payment of $20.5 million was received on the closing date and the remaining $6.2 million was in the form of a five-year note from the buyer. PolyOne does not expect to recognize any further gain or loss in 2006 from the transaction. PolyOne retained an 18% ownership interest in the company. Under EITF 03-13, "Applying the Conditions in Paragraph 42 of FASB Statement No. 144 in Determining Whether to Report Discontinued Operations," when a business is sold with a retained interest, the cost method of accounting is appropriate if the disposal group qualifies as a compo-

nent of an entity, the selling entity has no significant influence or continuing involvement in the new entity, and the operations and cash flows of the business being sold will be eliminated from the ongoing operations of the company selling it. The Engineered Films business qualified as a component of an entity and PolyOne will have no significant influence or continuing involvement in the new entity. Activities that would be considered continuing cash flows (consisting of warehousing services and short-term transitional services) amount to less than one percent of the new entity's corresponding costs, and for that reason are not considered significant. The operations and cash flows of the business being sold will be eliminated from the ongoing operations of PolyOne. PolyOne also considered the provisions of FASB Interpretation No. 46, "Consolidation of Variable Interest Entities," and determined that the new entity would not be a variable interest entity subject to consolidation. As a result, the retained minority interest investment in the Engineered Films business will be reported on the cost method of accounting. The carrying amount of the major classes of assets and liabilities of Engineered Films at December 31, 2005 is reflected in "Discontinued operations" in the Consolidated Balance Sheets.

The following table summarizes the results of discontinued operations. As required by generally accepted accounting principles in the United States, 2005 and 2004 results of discontinued operations do not include any depreciation or amortization expense.

| (In millions) | 2005 | 2004 | 2003 |
|---|---|---|---|
| Sales: | | | |
| Elastomers and Performance Additives | $ — | $220.1 | $ 348.1 |
| Engineered Films | 119.6 | 125.7 | 139.3 |
| | $119.6 | $345.8 | $ 487.4 |
| Pre-tax income (loss) from operations: | | | |
| Elastomers and Performance Additives | $ — | $ 17.2 | $ 3.5 |
| Engineered Films | 0.5 | 0.6 | (27.9) |
| | 0.5 | 17.8 | (24.4) |
| Pre-tax loss on disposition of businesses: | | | |
| Elastomers and Performance Additives | (0.7) | (17.0) | (92.6) |
| Engineered Films | (15.1) | (4.3) | (26.5) |
| | (15.3) | (3.5) | (143.5) |
| Income tax expense, net of valuation allowance | — | (0.6) | (1.2) |
| Loss from discontinued operations | $(15.3) | $ (4.1) | $(144.7) |

**Note C – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Consolidation and Basis of Presentation** – The Consolidated Financial Statements include the accounts of PolyOne and its subsidiaries. All majority-owned affiliates over which PolyOne has control are consolidated. Investments in affiliates and joint ventures in which PolyOne's ownership is 50% or less, or in which PolyOne does not have control but has the ability to exercise significant influence over operating and financial policies, are accounted for under the equity method. Intercompany transactions are eliminated. Transactions with related parties, including joint ventures, are in the ordinary course of business.

**Cash and Cash Equivalents** – PolyOne considers all highly liquid investments purchased with a maturity of less than three months to be cash equivalents. Cash equivalents are stated at cost, which approximates fair value.

**Allowance for Doubtful Accounts** – PolyOne evaluates the collectibility of trade receivables based on a combination of factors. PolyOne regularly analyzes significant customer accounts and, when PolyOne becomes aware of a specific customer's inability to meet its financial obligations to PolyOne, such as in the case of a bankruptcy filing or deterioration in the customer's operating results or financial position, PolyOne records a specific reserve for bad debt to reduce the related receivable to the amount PolyOne reasonably believes is collectible. PolyOne also records bad debt reserves for all other customers based on a variety of factors including the length of time the receivables are past due, the financial health of the customer, economic conditions and historical experience. If circumstances related to specific customers change, PolyOne's estimates of the recoverability of receivables could be adjusted further.

**Concentrations of Credit Risk** – Financial instruments that subject PolyOne to potential credit risk are trade accounts receivable, foreign exchange contracts and interest rate swap agreements. Concentration of credit risk for trade accounts receivable is limited due to the large number of customers constituting its customer base and their distribution among many industries and geographic locations. PolyOne is exposed to credit risk with respect to forward foreign exchange contracts and interest rate swap agreements in the event of non-performance by the counter-parties to these financial instruments. Management believes that the risk of incurring material losses related to this credit risk is remote.

**Sale of Accounts Receivable** – PolyOne follows the provisions of SFAS No. 140, "Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities." As a result, trade accounts receivable that are sold are removed from the balance sheet at the time of sale.

**Inventories** – Inventories are stated at the lower of cost or market. Approximately 39% and 42% of PolyOne's inventories at December 31, 2005 and 2004 are valued using the last-in, first-out (LIFO) cost method. Inventories not valued by the LIFO method are valued using the first-in, first-out (FIFO) or average cost method.

**Property and Depreciation** – Property, plant and equipment is recorded at cost, net of depreciation and amortization that is computed principally using the straight-line method over the

estimated useful life of the assets, which ranges from three to 15 years for machinery and equipment and up to 40 years for buildings. Computer software is amortized over periods not exceeding ten years. Property, plant and equipment is generally depreciated on accelerated methods for income tax purposes. Repair and maintenance costs are expensed as incurred.

Depreciation expense was $48.0 million in 2005, $47.3 million in 2004 and $53.5 million in 2003.

**Impairment of Long-Lived Assets** – As required by SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," PolyOne reviews long-lived assets for impairment when circumstances indicate that the carrying value of an asset may not be recoverable. For assets that are to be held and used, an impairment charge is recognized when the estimated undiscounted future cash flows associated with the asset or group of assets are less than their carrying value. If an impairment exists, an adjustment is made to write the asset down to its fair value, and a loss is recorded for the difference between the carrying value and the fair value. Fair values are determined based on quoted market values, discounted cash flows, internal appraisals or external appraisals, as applicable. Assets to be disposed of are carried at the lower of their carrying value or estimated net realizable value.

**Goodwill and Other Intangible Assets** – Goodwill is the excess of the purchase price paid over the fair value of the net assets of the acquired business. Goodwill is subject to annual impairment testing. Other intangible assets, which consist primarily of non-contractual customer relationships, sales contracts, patents and technology, are amortized over their estimated useful lives. The remaining lives range from three to 20 years.

Total amortization expense of other intangibles was $2.7 million in 2005, $3.6 million in 2004 and $4.2 million in 2003.

**Derivative Financial Instruments** – SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," requires that all derivative financial instruments, such as foreign exchange contracts and interest rate swap agreements, be recognized in the financial statements and measured at fair value, regardless of the purpose or intent in holding them. Changes in the fair value of derivative financial instruments are recognized in the period when the change occurs in either net income or shareholders' equity (as a component of accumulated other comprehensive income or loss), depending on whether the derivative is being used to hedge changes in fair value or cash flows.

PolyOne is exposed to foreign currency changes and interest rate fluctuations in the normal course of business. PolyOne has established policies and procedures that manage these exposures through the use of financial instruments. By policy, PolyOne does not enter into these instruments for trading purposes or speculation.

PolyOne enters into foreign currency exchange forward contracts with major financial institutions to reduce the effect of fluctuating exchange rates, primarily on foreign currency inter-company lending transactions. These contracts are not treated as hedges and, as a result, are marked to market, with the resulting gains and losses recognized as other income or expense in the Consolidated Statements of Operations. Realized gains and losses on these contracts offset the foreign exchange gains and losses on the underlying transactions. PolyOne's forward contracts have original maturities of one month.

From time to time, PolyOne also enters into interest rate swap agreements that modify the exposure to interest risk by converting fixed-rate debt to a floating rate. The interest rate swap and instrument being hedged are marked to market in the balance sheet. The net effect on PolyOne's operating results is that interest expense on the portion of fixed-rate debt being hedged is recorded based on the variable rate that is stated within the swap agreement. No other cash payments are made unless the contract is terminated prior to its maturity. In this case, the amount paid or received at settlement is established by agreement at the time of termination and usually represents the net present value, at current rates of interest, of the remaining obligations to exchange payments under the terms of the contract. Any gains or losses upon the early termination of interest rate swap contracts are deferred within the hedged item and recognized over the remaining life of the contract. During 2004, PolyOne terminated one interest rate swap agreement and paid cash of $0.3 million. The deferred losses and gains were classified as long-term debt and are being amortized over the remaining life of the related debt instruments. See Note T for more information.

**Revenue Recognition** – Revenue is recognized when title passes to the customer, based on shipping terms for the product sold or when the service is performed.

**Shipping and Handling Costs** – Shipping and handling costs are included in cost of sales.

**Equity Affiliates** – PolyOne recognizes its proportionate share of the income of equity affiliates. Losses of equity affiliates are recognized to the extent of PolyOne's investment, advances, financial guarantees and other commitments to provide financial support to the investee. Any losses in excess of this amount are deferred and reduce the amount of future earnings of the equity investee recognized by PolyOne. At December 31, 2005 and 2004, there were no deferred losses related to equity investees.

PolyOne accounts for its investments in equity affiliates under APB No. 18, "The Equity Method of Accounting for Investments in Common Stock," and recognizes impairment losses in the value of investments that management judges to be other than temporary. See Note F for more information.

**Environmental Costs** – PolyOne expenses recurring costs that are associated with managing hazardous substances and pollution

in ongoing operations on a current basis. Costs associated with the remediation of environmental contamination are accrued when it becomes probable that a liability has been incurred and PolyOne's proportionate share of the amount can be reasonably estimated.

**Research and Development Expense** – Research and development costs, which were $16.9 million in 2005, $15.6 million in 2004 and $18.5 million in 2003, are charged to expense as incurred.

**Income Taxes** – Deferred tax liabilities and assets are determined based upon the differences between the financial reporting and tax basis of assets and liabilities, and are measured using the tax rate and laws currently in effect.

**Foreign Currency Translation** – Revenues and expenses are translated at average currency exchange rates during the related period. Assets and liabilities of foreign subsidiaries and equity investees are translated using the exchange rate at the end of the period. PolyOne's share of the resulting translation adjustment is recorded as accumulated other comprehensive income or loss in shareholders' equity. The cumulative unrecognized translation adjustment loss was $20.0 million at December 31, 2005, $10.7 million at December 31, 2004 and $18.6 million at December 31, 2003. Gains and losses resulting from foreign currency transactions, including intercompany transactions that are not considered permanent investments, are included in net income.

**Marketable Securities** – Marketable securities are classified as available for sale and are presented at current market value. Net unrealized gains and losses on marketable securities available for sale are credited or charged as accumulated other comprehensive income or loss in shareholders' equity.

**Stock-Based Compensation** – As provided under SFAS No. 123, "Accounting for Stock Based Compensation," PolyOne accounts for stock-based compensation under the provisions of APB Opinion No. 25, "Accounting for Stock Issued to Employees." Compensation cost for stock options is measured as the excess, if any, of the quoted market price of the PolyOne stock at the date of the grant over the amount an option holder must pay to acquire the stock. Compensation cost for stock appreciation rights (SARs) is recognized upon vesting, and is the amount by which the quoted market value of the shares of PolyOne stock covered by the grant exceeds the SARs specified value. At December 31, 2005, 1.5 million SARs were issued and outstanding, of which 0.8 million were vested and exercisable at share prices ranging from $6.00 to $12.22.

The following pro forma information regarding net income (loss) and net income (loss) per share is required by SFAS No. 123 and has been determined as if PolyOne had accounted for its equity based awards under the fair value method of that statement. The weighted-average fair value per share of equity awards granted in 2005 was $4.18, in 2004 was $3.57 and in 2003 was $2.46. The fair value of these awards was estimated at the grant date using the following weighted-average assumptions:

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| Risk-free interest rate | 3.8% | 4.1% | 3.6% |
| Expected dividend yield | 0.0% | 0.0% | 0.0% |
| Expected lives | 5 years | 7 years | 7 years |
| Expected volatility | 42.0% | 42.3% | 43.8% |

The Black-Scholes-Merton option-pricing model was used to value stock options. The Black-Scholes-Merton option-pricing model was developed to estimate the fair value of traded options that have no vesting restrictions and are fully transferable. A binomial model using Monte Carlo simulation was used to value SARs.

The following table illustrates the effect on net income (loss) and earnings (loss) per common share if PolyOne had applied the fair value recognition provisions of SFAS No. 123 to stock-based compensation, using the fair value estimate.

| | For the Years Ended December 31, | | |
|---|---|---|---|
| (In millions, except per share data) | 2005 | 2004 | 2003 |
| Net income (loss), as reported | $46.9 | $23.5 | $(251.1) |
| Add: Total stock-based employee compensation (benefit) expense included in reported net income (loss), net of tax | (0.6) | 2.7 | 1.4 |
| Deduct: Total stock-based employee compensation expense determined under fair value-based method for all awards, net of tax | (4.1) | (4.3) | (5.3) |
| Pro forma net income (loss) | $42.2 | $21.9 | $(255.0) |
| Earnings (loss) per common share: | | | |
| Basic and diluted – as reported | $0.51 | $0.26 | $ (2.76) |
| Basic and diluted – pro forma | $0.46 | $0.24 | $ (2.80) |

**New Accounting Pronouncements** – On December 16, 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-Based Payment," which revised SFAS No. 123, "Accounting for Stock-Based Compensation." SFAS No. 123(R) supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees," and amends SFAS No. 95, "Statement of Cash Flows." The approach in SFAS No. 123(R) is similar to the approach described in SFAS No. 123. However, SFAS No. 123(R) requires that all share-based payments to employees, including grants of employee stock options, be recognized in the income statement based on their fair values. Pro forma disclosure will no longer be an alternative.

PolyOne adopted SFAS No. 123(R) using the modified-prospective method as of January 1, 2006. The modified-prospective method requires the recognition of compensation costs beginning with the effective date for all share-based payments that are granted after the effective date and for all awards that are granted to employees prior to the effective date that remain

unvested on the effective date. PolyOne currently estimates that the impact of adopting SFAS No. 123(R) will be an additional pre-tax charge in 2006 of approximately $3 million based on unvested awards issued prior to the effective date of 123(R) and the new awards issued after the effective date on January 1, 2006.

Through December 31, 2005, as permitted by SFAS No. 123, PolyOne accounted for share-based payments to employees using APB Opinion No. 25's intrinsic value method and, as such, generally recognized no compensation cost for employee equity awards. The adoption of SFAS No. 123(R)'s fair value method will have an impact on PolyOne's results of operations, but it will have no impact on its overall financial position. Had PolyOne adopted SFAS No. 123(R) in prior periods, the impact of that standard would have approximated the impact of SFAS No. 123 as described in the disclosure of pro forma net income and earnings per share shown previously in this Note C. SFAS No. 123(R) also requires that the benefits of tax deductions in excess of recognized compensation be reported as a financing cash flow, rather than as an operating cash flow as required by current literature. This requirement will reduce net operating cash flows and increase net financing cash flows in the periods after adoption. However, since the Company is in a net operating loss carryforward position for income taxes, there would have been no impact on its cash flow statements for each of the three years in the period ended December 31, 2005.

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs." SFAS No. 151 amends Accounting Research Bulletin (ARB) No. 43, Chapter 4, "Inventory Pricing," to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material. SFAS No. 151 requires that these items be recognized as current-period charges and requires that the allocation of fixed production overhead to the costs of conversion be based on the normal capacity of the associated production facilities. PolyOne adopted SFAS No. 151 effective January 1, 2006. The adoption of SFAS No. 151 is not expected to have a material impact on the Company's financial position or results of operations.

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections." SFAS No. 154 applies to all voluntary changes in accounting principle and to changes required by an accounting pronouncement that do not include explicit transition provisions. SFAS No. 154 requires that changes in accounting principle be applied retroactively, instead of including the cumulative effect in the income statement. The correction of an error will continue to require financial statement restatement. A change in accounting estimate will continue to be accounted for in the period of change and in subsequent periods, if necessary. PolyOne adopted SFAS No. 154 as of January 1, 2006. The adoption of SFAS No. 154 is not expected to have a material impact on the Company's financial position or results of operations.

**Use of Estimates** – The preparation of Consolidated Financial Statements in conformity with generally accepted accounting principles requires management to make extensive use of estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the Consolidated Financial Statements, and the reported amounts of revenues and expenses during these periods. Significant estimates in these Consolidated Financial Statements include sales discounts and rebates, restructuring charges, 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 and asbestos-related liabilities, income taxes and tax valuation reserves, goodwill 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.

**Reclassification** – Certain amounts for 2004 and 2003 have been reclassified to conform to the 2005 presentation.

**Consolidated Statements of Cash Flows** – In 2005, PolyOne has separately disclosed the operating, investing and financing portions of the cash flows that were attributable to its discontinued operations. In prior periods cash flows attributable to discontinued operations were reported on a combined basis on one separate line item.

## Note D – GOODWILL AND INTANGIBLE ASSETS

Under SFAS No. 142, "Goodwill and Other Intangible Assets," goodwill and intangible assets that have indefinite lives must be tested for impairment at least once a year. Carrying values are compared with fair values, and when the carrying value exceeds the fair value, the carrying value of the impaired asset is reduced to its fair value.

Changes in the carrying amount of goodwill for the years ended December 31, 2005 and 2004 by segment are as follows:

| (In millions) | Performance Plastics | Distribution | Total |
|---|---|---|---|
| **January 1, 2004** | $332.9 | $1.1 | $334.0 |
| Business acquisition | 1.8 | 0.5 | 2.3 |
| Business divestiture | (9.0) | — | (9.0) |
| Reduction of acquired tax accrual | (6.1) | — | (6.1) |
| Translation adjustment | (0.2) | — | (0.2) |
| **December 31, 2004** | $319.4 | $1.6 | $321.0 |
| Business acquisition | 1.0 | — | 1.0 |
| Reduction of acquired tax accrual | (6.7) | — | (6.7) |
| **December 31, 2005** | $313.7 | $1.6 | $315.3 |

PolyOne acquired the remaining 16% of Star Color, a Thailand-based color and additives business, in the first quarter of 2005.

The reduction of the acquired tax accrual represents an adjustment to goodwill from resolving income tax uncertainties that existed prior to the business combination of Geon and Hanna.

As of December 31, 2005, PolyOne had $315.3 million of goodwill that resulted from acquiring businesses. SFAS No. 142 requires an annual assessment for potential impairment of goodwill. PolyOne has elected July 1 as its annual assessment date.

PolyOne uses a combination of two valuation methods, a market approach and an income approach, to estimate the fair value of its reporting units. Absent an indication of fair value from a potential buyer or similar specific transactions, the Company believes that the use of these two methods provides reasonable estimates of a reporting unit's fair value. Fair value computed by these two methods is arrived at using a number of factors, including projected future operating results and business plans, economic projections, anticipated future cash flows, comparable marketplace data within a consistent industry grouping, and the cost of capital. There are inherent uncertainties, however, related to these factors and to management's judgment in applying them to this analysis. Nonetheless, management believes that the combination of these two methods provides a reasonable approach to estimate the fair value of PolyOne's reporting units. No assumptions or estimates differed between these two methods as of any valuation date for each reporting unit.

SFAS No. 142 requires that this assessment be performed at the "reporting unit" level. PolyOne has identified two reporting units within the Performance Plastics segment: Polymer Coatings Systems and Plastic Compounds and Colors. The Polymer Coatings Systems reporting unit is comprised of businesses acquired after the formation of PolyOne that produce liquid polymer coating systems that use a base resin of specialty vinyl resin, natural rubber latex or polyurethane resin. Goodwill associated with the Polymer Coating Systems reporting unit was $60.5 million as of December 31, 2005 and resulted from the purchase accounting that was done at the time of each acquisition. The Plastic Compounds and Colors reporting unit is comprised of businesses that were in existence at the formation of PolyOne that produce specialty vinyl resins and vinyl-based compounds. Goodwill associated with the Plastic Compounds and Colors reporting unit was $253.2 million as of December 31, 2005 and resulted from the original purchase accounting that was done when PolyOne was formed.

The market approach estimates fair value by applying sales, earnings and cash flow multiples (derived from comparable publicly-traded companies with similar investment characteristics of the reporting unit) to the reporting unit's operating performance adjusted for non-recurring items. Management believes that this approach is appropriate because it provides a fair value estimate using multiples from entities with operations and economic characteristics comparable to PolyOne's reporting units. The key estimates and assumptions that are used to determine fair value under this approach include projected future results and a control premium applied to the market multiples to adjust the enterprise value upward for a 100% ownership interest, where applicable. Projected results for the next 12 months are used due to the forward-looking nature of the market-related multiples. Projected future results are based upon management's best estimates, which take into account projected economic and market conditions and the reporting unit's business plans.

The income approach is based on projected future debt-free cash flow that is discounted to present value using factors that consider the timing and risk of the future cash flows. Management believes that this approach is appropriate because it provides a fair value estimate based upon the reporting unit's expected long-term operating and cash flow performance. This approach also mitigates most of the impact of cyclical downturns that occur in the reporting unit's industry. The income approach is based on a reporting unit's five- to ten-year projection of operating results and cash flows that is discounted using a weighted-average cost of capital that is calculated for the reporting unit's industry. The projection is based upon management's best estimates of projected economic and market conditions over the related period including growth rates, estimates of future expected changes in operating margins and cash expenditures. Other significant estimates and assumptions include terminal value growth rates, terminal value margin rates, future capital expenditures and changes in future working capital requirements based on management projections.

Under SFAS No. 142, a detailed determination of a reporting unit's fair value may be carried forward from one year to the next if certain criteria are met. These criteria are: 1) the assets and liabilities of the reporting unit have not changed significantly since the last fair value determination; 2) the most recent fair value determination resulted in an amount that exceeded the carrying value of the reporting unit by a substantial amount; and 3) based on events and circumstances, the likelihood of a determination of fair value being less than the carrying value is remote. The average fair values of the Plastic Compounds and Colors reporting unit exceeded the carrying value by 74% as of July 1, 2004. These three criteria were met for the Plastic Compounds and Colors reporting unit and annual testing was deemed not to be necessary as of July 1, 2005.

As a result, only the Polymer Coating Systems reporting unit required testing under the provisions of SFAS No. 142 as of July 1, 2005. The average fair values of the market approach and income approach exceeded the carrying value by 27% for the Polymer Coating Systems reporting unit as of July 1, 2005. Using the lowest fair value determined by these two methodologies would have resulted in a fair value that exceeded the carrying value by 22%.

Even though PolyOne determined that there was no additional goodwill impairment as of the July 1, 2005 annual assessment, the future occurrence of a potential indicator of impairment, such as a significant adverse change in legal factors or business climate, an adverse action or assessment by a regulator, unanticipated competition, a material negative change in relationships with significant

customers, strategic decisions made in response to economic or competitive conditions, loss of key personnel or a more-likely-than-not expectation that a reporting unit or a significant portion of a reporting unit will be sold or disposed of, would require an interim assessment for some or all of the reporting units prior to the next required annual assessment on July 1, 2006.

Information regarding other intangible assets follows:

| | As of December 31, 2005 | | | |
|---|---|---|---|---|
| (In millions) | Acquisition Cost | Accumulated Amortization | Currency Translation | Net |
| Non-contractual customer relationships | $ 8.6 | $ (5.6) | $ — | $ 3.0 |
| Sales contract | 9.6 | (8.4) | — | 1.2 |
| Patents, technology and other | 7.3 | (2.0) | 1.1 | 6.4 |
| Total | $25.5 | $(16.0) | $1.1 | $10.6 |

| | As of December 31, 2004 | | | |
|---|---|---|---|---|
| (In millions) | Acquisition Cost | Accumulated Amortization | Currency Translation | Net |
| Non-contractual customer relationships | $ 8.6 | $ (4.4) | $ — | $ 4.2 |
| Sales contract | 9.6 | (7.7) | — | 1.9 |
| Patents, technology and other | 4.1 | (1.2) | 1.1 | 4.0 |
| Total | $22.3 | $(13.3) | $1.1 | $10.1 |

Amortization of other intangible assets was $2.7 million for the year ended December 31, 2005 and $3.6 million for the year ended December 31, 2004. Amortization expense for each of the next five years is expected to be approximately $2 million per year.

The carrying values of intangible assets and other investments are adjusted to estimated net future cash flows as a result of an evaluation done each year end, or more often when indicators of impairment exist. The following non-cash impairment charges were recorded:

| (In millions) | 2005 | 2004 | 2003 |
|---|---|---|---|
| Customer contract – lower profit expectations | — | 3.3 | — |
| Customer lists – lower profit expectations | — | — | 4.3 |
| Technology investment deemed to be not marketable | — | — | 0.7 |

**Note E – EMPLOYEE SEPARATION AND PLANT PHASEOUT**

Since the formation of PolyOne in 2000, management has undertaken several restructuring initiatives to improve profitability and, as a result, PolyOne has incurred employee separation and plant phaseout costs.

Employee separation costs include salary continuation benefits, medical coverage and outplacement assistance and are based upon a formula that takes into account each individual employee's base compensation and length of service. PolyOne maintains a severance plan that provides specific benefits to all employees (except those who are employed under collective bargaining agreements) who lose their jobs due to reduction in workforce or job elimination initiatives, or from closing manufacturing facilities. Collective bargaining employees are covered under the terms of each specific agreement. The amount is determined separately for each employee and is recognized at the date the employee is notified if the expected termination date will be within 60 days of notification or is accrued on a straight-line basis over the period from the notification date to the expected termination date if the termination date is more than 60 days after the notification date.

Plant phaseout costs include the impairment of property, plant and equipment at manufacturing facilities, and the resulting write-down of the carrying value of these assets to fair value, which represents management's best estimate of the net proceeds to be received for the assets to be sold or scrapped, less any costs to sell. Plant phaseout costs also include cash facility closing costs and lease termination costs. Assets transferred to other PolyOne facilities are transferred at net book value.

Plant phaseout costs associated with continuing operations are reflected on the Consolidated Statements of Operations on the line "Employee separation and plant phaseout." Plant phaseout costs associated with discontinued operations are included in the Consolidated Statements of Operations on the line "Loss from discontinued operations, net of income taxes." Plant phaseout costs for continuing operations relate to the Performance Plastics segment, and plant phaseout costs for discontinued operations relate to the Engineered Films business, formerly included in the Performance Plastics segment, and the Elastomers and Performance Additives business, which was previously reported as a separate segment. For more information, see Note F to the Consolidated Financial Statements included in PolyOne's Annual Report on Form 10-K for the year ended December 31, 2004.

**2005 Charges** – Employee separation and plant phaseout costs for 2005 were $5.5 million. Operating income includes a $2.5 million charge to be paid pursuant to the terms of an October 6, 2005 separation agreement between PolyOne and Thomas A. Waltermire as the President, Chief Executive Officer and a Director. The amounts accrued at December 31, 2005 are expected to be paid out through 2008.

The $2.5 million loss on the sale of facilities and equipment of previously idled operations reflects the amount in excess of the estimate at December 31, 2004 when the carrying value of these assets was reduced to estimated future net proceeds.

Operating income was also reduced by $0.5 million from the November 2005 announcement to close the Company's Manchester, England plastic color additives facility by the end of the first quarter of 2006. Of the 44 employees affected by the facility closing, 22 were terminated by December 31, 2005. An additional charge of $0.3 million for employee separation will be recognized in the first quarter of 2006 as the plant phaseout is completed.

Loss from discontinued operations reflects a $0.2 million benefit relative to employee separation costs as a result of adjusting estimates when the activities were completed.

**2004 Charges** – Operating income includes a $1.4 million benefit from adjusting the estimated remaining liabilities associated with restructuring initiatives announced in prior years. Loss from discontinued operations included a $7.5 million pre-tax charge from closing an Engineered Films' manufacturing facility and two Elastomers and Performance Additives' manufacturing facilities in the first quarter of 2004. All of the employees who were affected by the restructuring initiatives announced in 2004 and prior years were terminated as of December 31, 2004.

**2003 Charges** – Operating income for 2003 was reduced by $35.7 million for employee separation and plant phaseout costs resulting from a January 2003 announcement to reduce approximately 400 staff personnel, a June 2003 decision to close the Fort Worth, Texas Color Additives facility, and the adjustment of the remaining liabilities associated with restructuring initiatives that had been announced in prior years. During the third quarter of 2003, PolyOne also closed two leased Ohio administrative offices, closed a portion of the Mexico Distribution business and reduced personnel levels in certain North American manufacturing facilities. Charges of $25.8 million that were included in discontinued operations resulted primarily from decisions to close an Engineered Films plant and two Elastomers and Performance Additives plants.

The following table summarizes the provisions, payments and remaining reserves associated with each of these initiatives from December 31, 2003 through December 31, 2005:

| | Employee Separation | | Plant Phaseout Costs | | |
|---|---|---|---|---|---|
| (In millions, except employee numbers) | Number of Employees | Costs | Cash Closure | Asset Writedowns | Total |
| **January 2003 reduction of staff personnel** | | | | | |
| Balance at January 1, 2003 | — | $ — | $ — | $ — | $ — |
| Continuing operations charge | 400 | 18.3 | | | 18.3 |
| Discontinued operations charge | | 2.4 | | | 2.4 |
| Utilized 2003 | (400) | (19.2) | | | (19.2) |
| Balance at December 31, 2003 | — | $ 1.5 | $ — | $ — | $ 1.5 |
| Continuing operations benefit | | (0.5) | | | (0.5) |
| Utilized 2004 | | (1.0) | | | (1.0) |
| Balance at December 31, 2004 | — | $ — | $ — | $ — | $ — |
| Balance at December 31, 2005 | — | $ — | $ — | $ — | $ — |

| | Employee Separation | | Plant Phaseout Costs | | |
|---|---|---|---|---|---|
| (In millions, except employee numbers) | Number of Employees | Costs | Cash Closure | Asset Writedowns | Total |
| **Performance Plastics restructuring announced in 2001** | | | | | |
| Balance at January 1, 2003 | 40 | $ 13.5 | $ 1.1 | $ — | $ 14.6 |
| Continuing operations charge (benefit) | | (3.6) | 0.3 | 1.1 | (2.2) |
| Utilized 2003 | (40) | (9.0) | (1.3) | (1.1) | (11.4) |
| Balance at December 31, 2003 | — | $ 0.9 | $ 0.1 | $ — | $ 1.0 |
| Continuing operations benefit | | (0.9) | (0.1) | (0.3) | (1.3) |
| Utilized 2004 | | | | 0.3 | 0.3 |
| Balance at December 31, 2004 | — | $ — | $ — | $ — | $ — |
| Balance at December 31, 2005 | — | $ — | $ — | $ — | $ — |

| (In millions, except employee numbers) | Employee Separation | | Plant Phaseout Costs | | |
|---|---|---|---|---|---|
| | Number of Employees | Costs | Cash Closure | Asset Writedowns | Total |
| **Closure and exit of Engineered Films manufacturing plants** | | | | | |
| Balance at January 1, 2003 | — | $ — | $ — | $ — | $ — |
| Discontinued operations charge | 199 | 4.8 | 3.2 | 7.1 | 15.1 |
| Utilized 2003 | (82) | (2.2) | (0.9) | (7.1) | (10.2) |
| Balance at December 31, 2003 | 117 | $ 2.6 | $ 2.3 | $ — | $ 4.9 |
| Discontinued operations charge | | 3.6 | (0.1) | | 3.5 |
| Utilized 2004 | (117) | (5.2) | (1.4) | | (6.6) |
| Balance at December 31, 2004 | — | $ 1.0 | $ 0.8 | $ — | $ 1.8 |
| Discontinued operations benefit | | (0.2) | | | (0.2) |
| Utilized 2005 | | (0.8) | (0.8) | | (1.6) |
| Balance at December 31, 2005 | — | $ — | $ — | $ — | $ — |

| (In millions, except employee numbers) | Employee Separation | | Plant Phaseout Costs | | |
|---|---|---|---|---|---|
| | Number of Employees | Costs | Cash Closure | Asset Writedowns | Total |
| **Wynne, Arkansas and Deforest, Wisconsin production facility closures** | | | | | |
| Balance at January 1, 2003 | — | $ — | $ — | $ — | $ — |
| Discontinued operations charge | 137 | 1.6 | | 5.5 | 7.1 |
| Utilized 2003 | | | | (5.5) | (5.5) |
| Balance at December 31, 2003 | 137 | $ 1.6 | $ — | $ — | $ 1.6 |
| Discontinued operations charge | | 1.0 | 2.5 | | 3.5 |
| Utilized 2004 | (137) | (2.6) | (2.5) | | (5.1) |
| Balance at December 31, 2004 | — | $ — | $ — | $ — | $ — |
| Balance at December 31, 2005 | — | $ — | $ — | $ — | $ — |

| (In millions, except employee numbers) | Employee Separation | | Plant Phaseout Costs | | |
|---|---|---|---|---|---|
| | Number of Employees | Costs | Cash Closure | Asset Writedowns | Total |
| **June 2003 closure of Ft. Worth, Texas color additives plant** | | | | | |
| Balance at January 1, 2003 | — | $ — | $ — | $ — | $ — |
| Continuing operations charge | 32 | 0.5 | 0.4 | 2.7 | 3.6 |
| Utilized 2003 | (32) | (0.5) | (0.4) | (2.7) | (3.6) |
| Balance at December 31, 2003 | — | $ — | $ — | $ — | $ — |
| Continuing operations charge | | 0.6 | | | 0.6 |
| Utilized 2004 | | (0.6) | | | (0.6) |
| Balance at December 31, 2004 | — | $ — | $ — | $ — | $ — |
| Balance at December 31, 2005 | — | $ — | $ — | $ — | $ — |

| (In millions, except employee numbers) | Employee Separation | | Plant Phaseout Costs | | |
|---|---|---|---|---|---|
| | Number of Employees | Costs | Cash Closure | Asset Writedowns | Total |
| **Mexico & North America administrative staff reductions** | | | | | |
| Balance at January 1, 2003 | — | $ — | $ — | $ — | $ — |
| Continuing operations charge | 340 | 12.9 | 2.6 | 0.5 | 16.0 |
| Discontinued operations charge | | 1.2 | | | 1.2 |
| Utilized 2003 | (189) | (5.1) | (0.4) | (0.5) | (6.0) |
| Balance at December 31, 2003 | 151 | $ 9.0 | $ 2.2 | $ — | $ 11.2 |
| Continuing operations benefit | | (0.2) | | | (0.2) |
| Discontinued operations charge | | 0.5 | | | 0.5 |
| Utilized 2004 | (151) | (8.5) | (1.5) | | (10.0) |
| Balance at December 31, 2004 | — | $ 0.8 | $ 0.7 | $ — | $ 1.5 |
| Continuing operations charge | | | | 2.5 | 2.5 |
| Utilized 2005 | | (0.8) | (0.7) | (2.5) | (4.0) |
| Balance at December 31, 2005 | — | $ — | $ — | $ — | $ — |

| (In millions, except employee numbers) | Employee Separation | | Plant Phaseout Costs | | |
|---|---|---|---|---|---|
| | Number of Employees | Costs | Cash Closure | Asset Writedowns | Total |
| **Executive severance** | | | | | |
| Balance at December 31, 2004 | — | $ — | $ — | $ — | $ — |
| Continuing operations charge | 1 | 2.5 | | | 2.5 |
| Utilized 2005 | (1) | | | | — |
| Balance at December 31, 2005 | — | $2.5 | $ — | $ — | $2.5 |

| (In millions, except employee numbers) | Employee Separation | | Plant Phaseout Costs | | |
|---|---|---|---|---|---|
| | Number of Employees | Costs | Cash Closure | Asset Writedowns | Total |
| **Closure and exit of Manchester, England Color Additives facility** | | | | | |
| Balance at December 31, 2004 | — | $ — | $ — | $ — | $ — |
| Continuing operations charge | 44 | 0.5 | | | 0.5 |
| Utilized 2005 | (22) | (0.5) | | | (0.5) |
| Balance at December 31, 2005 | 22 | $ — | $ — | $ — | $ — |

| (In millions, except employee numbers) | Employee Separation | | Plant Phaseout Costs | | |
|---|---|---|---|---|---|
| | Number of Employees | Costs | Cash Closure | Asset Writedowns | Total |
| **Total** | | | | | |
| Balance at January 1, 2003 | 40 | $ 13.5 | $ 1.1 | $ — | $ 14.6 |
| Continuing operations charge | 772 | 28.1 | 3.3 | 4.3 | 35.7 |
| Discontinued operations charge | 336 | 10.0 | 3.2 | 12.6 | 25.8 |
| Utilized 2003 | (743) | (36.0) | (3.0) | (16.9) | (55.9) |
| Balance at December 31, 2003 | 405 | $ 15.6 | $ 4.6 | $ — | $ 20.2 |
| Continuing operations | | (1.0) | (0.1) | (0.3) | (1.4) |
| Discontinued operations | | 5.1 | 2.4 | | 7.5 |
| Utilized 2004 | (405) | (17.9) | (5.4) | 0.3 | (23.0) |
| Balance at December 31, 2004 | — | $ 1.8 | $ 1.5 | $ — | $ 3.3 |
| Continuing operations | 45 | 3.0 | | 2.5 | 5.5 |
| Discontinued operations | | (0.2) | | | (0.2) |
| Utilized 2005 | (23) | (2.1) | (1.5) | (2.5) | (6.1) |
| Balance at December 31, 2005 | 22 | $ 2.5 | $ — | $ — | $ 2.5 |

**Note F – Financial Information of Equity Affiliates**

PolyOne's Resin and Intermediates segment consists primarily of investments in equity affiliates.

PolyOne owns 24% of Oxy Vinyls, LP (OxyVinyls), a manufacturer and marketer of polyvinyl chloride (PVC) resins. OxyVinyls is a leading producer of PVC resins in North America. Summarized financial information for OxyVinyls follows:

| (In millions) | 2005 | 2004 | 2003 |
|---|---|---|---|
| OxyVinyls: | | | |
| Net sales | $2,502.0 | $2,272.5 | $1,760.4 |
| Operating income | $ 195.8 | $ 267.1 | $ 117.7 |
| Partnership income as reported by OxyVinyls | $ 129.9 | $ 199.8 | $ 92.4 |
| PolyOne's ownership of OxyVinyls | 24% | 24% | 24% |
| PolyOne's proportionate share of OxyVinyls' earnings | 31.2 | 48.0 | 22.2 |
| Amortization of the difference between PolyOne's investment and its underlying share of OxyVinyls' equity | 0.6 | 0.6 | 0.6 |
| Earnings of equity affiliate recorded by PolyOne | $ 31.8 | $ 48.6 | $ 22.8 |
| Current assets | $ 467.3 | $ 391.5 | |
| Non-current assets | 1,234.8 | 1,368.3 | |
| Total assets | 1,702.1 | 1,759.8 | |
| Current liabilities | 276.0 | 244.3 | |
| Non-current liabilities | 376.0 | 482.8 | |
| Total liabilities | 652.0 | 727.1 | |
| Partnership capital | $1,050.1 | $1,032.7 | |

OxyVinyls' income during 2005 includes a charge for the impairment of a previously idled chlor-alkali facility. PolyOne's share was $22.9 million.

PolyOne also owns 50% of SunBelt Chlor-Alkali Partnership (SunBelt). Summarized financial information for SunBelt follows:

| (In millions) | 2005 | 2004 | 2003 |
|---|---|---|---|
| SunBelt: | | | |
| Net sales | $167.0 | $105.8 | $97.0 |
| Operating income | $ 92.2 | $ 35.6 | $31.9 |
| Partnership income as reported by SunBelt | $ 81.3 | $ 23.5 | $18.8 |
| PolyOne's ownership of SunBelt | 50% | 50% | 50% |
| Earnings of equity affiliate recorded by PolyOne | $ 40.7 | $ 11.7 | $ 9.4 |
| Current assets | $ 28.4 | $ 18.9 | |
| Non-current assets | 120.5 | 125.5 | |
| Total assets | 148.9 | 144.4 | |
| Current liabilities | 19.4 | 18.0 | |
| Non-current liabilities | 134.1 | 146.3 | |
| Total liabilities | 153.5 | 164.3 | |
| Partnership deficit | $ (4.6) | $ (19.9) | |

OxyVinyls purchases chlorine from SunBelt under an agreement that expires in 2094. The agreement requires OxyVinyls to purchase all of the chlorine that is produced by SunBelt up to a maximum of 250,000 tons per year at market price, less a discount. OxyVinyls' chlorine purchases from SunBelt were $76.3 million in 2005 and $61.7 million in 2004.

The Performance Plastics segment includes DH Compounding Company (owned 50%), BayOne Urethane Systems L.L.C. (owned 50%) and Geon/ Polimeros Andinos (owned 50%) equity affiliates.

Combined summarized financial information for these equity affiliates follows. The amounts shown represent the entire operations of these businesses.

| (In millions) | 2005 | 2004 |
|---|---|---|
| Net sales | $127.0 | $116.0 |
| Operating income | $ 14.4 | $ 12.8 |
| Net income | $ 12.0 | $ 11.3 |
| Current assets | $ 34.9 | $ 33.3 |
| Non-current assets | 31.1 | 35.5 |
| Total assets | $ 66.0 | $ 68.8 |
| Current liabilities | $ 29.7 | $ 29.7 |
| Non-current liabilities | 2.8 | 1.7 |
| Total liabilities | $ 32.5 | $ 31.4 |

**Note G – FINANCING ARRANGEMENTS**

Long-term debt at December 31 consisted of the following:

| (In millions) | 2005 | 2004 |
|---|---|---|
| 6.875% debentures due 2005 | $ — | $ 29.2 |
| 10.625% senior notes due 2010 | 300.0 | 300.0 |
| 8.875% senior notes due 2012 | 198.9 | 198.7 |
| 7.500% debentures due 2015 | 50.0 | 50.0 |
| Medium-term notes – interest rates from 6.52% to 7.16% with a weighted average rate of 6.83% and 6.82% at December 31, 2005 and 2004, respectively – due between 2005 and 2011 | 90.5 | 110.3 |
| Colombian peso denominated notes, interest rate at 11.46%, due 2005 | — | 1.5 |
| Bank borrowings | — | 0.1 |
| Total long-term debt | $639.4 | $689.8 |
| Less current portion | 0.7 | 49.3 |
| Total long-term debt, net of current portion | $638.7 | $640.5 |

Aggregate maturities of long-term debt for the next five years are: 2006 – $0.7 million; 2007 – $19.2 million; 2008 – $18.6 million; 2009 – $17.8 million; 2010 – $317.3 million; and thereafter – $265.8 million.

As of December 31, 2005, PolyOne’s secured borrowings were not at levels that would trigger the security provisions of the indentures governing its senior notes and debentures and its guarantee of the SunBelt notes.

*Revolving Credit Facility* – During the third quarter of 2004, PolyOne amended its revolving credit facility to reduce the borrowing capacity from $50 million to $30 million to align borrowing capacity with credit requirements following the sale of the Elastomers and Performance Additives business, and because PolyOne would have limited access to amounts above $30 million without triggering the security provisions of the indentures governing the senior unsecured notes and debentures and the guarantee of the SunBelt notes. On July 26, 2005, PolyOne amended its revolving credit facility to modify the financial covenants. The revolving credit facility has a three-year term that expires in May 2006. The maximum amount that may be borrowed under the revolving credit facility is limited to 95% of the amount that may be borrowed and secured without triggering the security provisions of the indentures that govern the existing senior unsecured notes and debentures and the guarantee of the SunBelt notes. The revolving credit facility makes up to $30 million available for the issuance of standby letters of credit. Obligations under the revolving credit facility are secured by substantially all of PolyOne’s domestic intellectual property and inventory and some of its domestic real property.

As of December 31, 2005, PolyOne had no amounts outstanding under the revolving credit facility, although the facility served as a back-up facility for $6.0 million of outstanding letters of credit and for $5.0 million of loan guarantees related to PolyOne’s Shenzhen subsidiary. The amount available for borrowing under the revolving credit facility at December 31, 2005 was $13.8 million.

The weighted-average interest rate on short-term borrowings was 4.3% at December 31, 2005 and 3.7% at December 31, 2004. Total interest paid on long-term and short-term borrowings was $63.5 million in 2005, $69.2 million in 2004 and $63.2 million in 2003.

PolyOne is exposed to market risk from changes in interest rates on debt obligations and from changes in foreign currency exchange rates. PolyOne periodically enters into interest rate swap agreements that modify its exposure to interest risk by converting fixed-rate obligations to floating rates. On September 3, 2004, PolyOne terminated one of its seven existing interest rate swap agreements at a cash cost of $0.3 million. The six remaining agreements had a net fair value obligation of negative $5.8 million and negative $3.6 million at December 31, 2005 and 2004, respectively. The weighted-average interest rate for these six agreements was 8.2% at December 31, 2005 and 6.1% at December 31, 2004. These exchange agreements are “perfectly effective” as defined by SFAS No. 133, “Accounting for Derivative Financial Instruments and Hedging Activities.” There have been no material changes in the market risk faced by PolyOne from December 31, 2004 to December 31, 2005.

The following table shows the interest rate impact of the swap agreements at December 31, 2005 and 2004:

| | Effective Interest Rate at December 31, 2005 | Effective Interest Rate at December 31, 2004 |
|---|---|---|
| 6.875% debentures due in 2005 | — | 4.75% |
| $119.25 million of medium-term notes with a weighted-average interest rate of 6.82% | — | 5.40% |
| $100.75 million of medium-term notes with a weighted-average interest rate of 6.83% | 6.9% | — |

**Note H – LEASING ARRANGEMENTS**

PolyOne leases certain manufacturing facilities, warehouse space, machinery and equipment, automobiles and railcars under operating leases. Rent expense was $19.3 million in 2005, $18.3 million in 2004 and $21.8 million in 2003.

Future minimum lease payments under non-cancelable operating leases with initial lease terms longer than one year at December 31, 2005 were as follows: 2006 – $14.9 million; 2007 – $11.7 million; 2008 – $9.1 million; 2009 – $7.1 million; 2010 – $6.3 million; and thereafter – $14.6 million.

**Note I – SALE OF ACCOUNTS RECEIVABLE**

Accounts receivable at December 31 consist of the following:

| (In millions) | 2005 | 2004 |
|---|---|---|
| Trade accounts receivable | $139.6 | $151.8 |
| Retained interest in securitized accounts receivable | 187.3 | 169.1 |
| Allowance for doubtful accounts | (6.4) | (8.0) |
| | $320.5 | $312.9 |

Under the terms of its receivables sale facility, PolyOne sells its accounts receivable to PolyOne Funding Corporation (PFC), a wholly owned, bankruptcy-remote subsidiary. At December 31, 2005, accounts receivable totaling $195.2 million were sold by PolyOne to PFC and, as a result, are reflected as a reduction of accounts receivable on the Consolidated Balance Sheets. PFC in turn sells an undivided interest in these accounts receivable to certain investors and realizes proceeds of up to $175 million. The maximum proceeds that PFC may receive under the facility is limited to 85% of the eligible accounts receivable that are sold to PFC. At December 31, 2005, PFC had sold $7.9 million of its undivided interests in accounts receivable. PolyOne retained an interest in the $187.3 million difference between the amount of trade receivables that were sold by PolyOne to PFC and the undivided interests that were sold by PFC. As a result, this retained interest is included in accounts receivable on the Consolidated Balance Sheets at December 31, 2005.

As a result of the sale of the Elastomers and Performance Additives business in August 2004, the receivables sale facility was amended in the third quarter of 2004 to reduce the amount of eligible receivables that were available for sale from $225 million to $175 million. On July 26, 2005, PolyOne amended the receivables sale facility further to extend the expiration date to July 2010, reduce the cost of utilizing the facility and modify a financial covenant. As amended, PolyOne must maintain a minimum Fixed Charge Coverage Ratio, as defined in the agreement that governs the receivables sale facility, of at least one to one when the unused drawing availability under the facility is $40 million or less.

The receivables sale facility also makes up to $40 million available for the issuance of standby letters of credit as a sub-limit within the $175 million limit under the facility, of which $13 million was used at December 31, 2005. Continued availability of the securitization program depends upon compliance with covenants that are contained in the related agreements. As of December 31, 2005, PolyOne was in compliance with these covenants. The securitization agreement does not contain any credit rating downgrade triggers which could end the program.

PolyOne receives the remaining proceeds from collection of the receivables after a deduction for the aggregate yield payable on the undivided interests in the receivables sold by PFC, a servicer's fee, an unused commitment fee (between 0.25% and 0.50%, depending upon the amount of the unused portion of the facility), fees for any outstanding letters of credit, and an administration and monitoring fee ($150,000 per annum).

PolyOne also services the underlying accounts receivable and receives a service fee of 1% per annum on the average daily amount of the outstanding interests in its receivables. The net discount and other costs of the receivables sale facility are included in other expense, net in the Consolidated Statements of Operations.

**Note J – INVENTORIES**

| (In millions) | December 31, 2005 | December 31, 2004 |
|---|---|---|
| At FIFO or average cost, which approximates current cost: | | |
| Finished products and in process | $155.0 | $146.4 |
| Raw materials and supplies | 86.8 | 99.2 |
| | 241.8 | 245.6 |
| Reserve to reduce certain inventories to LIFO cost basis | (50.0) | (40.3) |
| | $191.8 | $205.3 |
| Percentage valued by the LIFO method | 39% | 42% |

**Note K – PROPERTY**

| (In millions) | December 31, 2005 | December 31, 2004 |
|---|---|---|
| Land and land improvements | $ 40.6 | $ 46.7 |
| Buildings | 253.4 | 254.8 |
| Machinery and equipment | 827.5 | 834.4 |
| | 1,121.5 | 1,135.9 |
| Less accumulated depreciation and amortization | (685.5) | (657.0) |
| | $ 436.0 | $ 478.9 |

**Note L – OTHER BALANCE SHEET LIABILITIES**

| | Accrued Expenses | | Non-current Liabilities | |
|---|---|---|---|---|
| | December 31, | | December 31, | |
| (In millions) | 2005 | 2004 | 2005 | 2004 |
| Employment costs | $39.4 | $ 48.1 | $ 12.8 | $ 13.7 |
| Environmental | 7.3 | 7.9 | 47.9 | 56.6 |
| Taxes | 8.2 | 13.8 | — | — |
| Post-retirement benefits | 8.9 | 11.4 | — | — |
| Interest | 7.7 | 7.9 | — | — |
| Pension | 4.8 | 5.5 | 135.4 | 120.1 |
| Employee separation and plant phaseout | 2.5 | 2.6 | — | 0.7 |
| Insurance accruals | 0.1 | 1.0 | 1.8 | 6.2 |
| Other | 3.5 | 10.8 | 16.4 | 36.4 |
| | $82.4 | $109.0 | $214.3 | $233.7 |

**Note M – EMPLOYEE BENEFIT PLANS**

PolyOne has two defined-benefit pension plans that accrue benefits for certain U.S. employees. The plans generally provide benefit payments using a formula that is based upon employee compensation and length of service, which was frozen as of December 31, 2002. All U.S. defined-benefit pension plans are closed to new participants.

PolyOne recorded an intangible asset of $0.1 million for funded and unfunded pension plans as of December 31, 2005, and of $0.2 million as of December 31, 2004. Accumulated other comprehensive income or loss in shareholders' equity included $133.4 million after tax at December 31, 2005 and $131.0 million after tax at December 31, 2004 for the accumulated minimum pension liability. The income tax benefit for the adjustment of the minimum pension liability was $0.2 million in 2005 and $7.3 million in 2004.

PolyOne also sponsors several unfunded defined-benefit post-retirement plans that provide subsidized health care and life insurance benefits to certain retirees and a closed group of eligible employees. Most of the health care plans are contributory. Retiree contributions are adjusted periodically, and these plans contain other cost-sharing features such as a maximum cap on the Company's cost, deductibles and cost sharing. Life insurance plans are generally non-contributory.

PolyOne uses December 31 as the measurement date for all of its plans. Effective December 31, 2005, PolyOne adopted the RP2000 mortality table to better estimate the future liabilities under its defined-benefit pension plans.

The following tables present the change in benefit obligation, change in plan assets and components of funded status for defined-benefit pension and post-retirement health care benefit plans. Actuarial assumptions that were used are also included.

| | Pension Benefits | | Health Care Benefits | |
|---|---|---|---|---|
| (In millions) | 2005 | 2004 | 2005 | 2004 |
| Change in benefit obligation: | | | | |
| Benefit obligation — beginning of year | $ 526.2 | $ 494.9 | $ 112.5 | $ 167.5 |
| Service cost | 1.3 | 1.1 | 0.4 | 0.5 |
| Interest cost | 28.9 | 29.6 | 5.9 | 8.2 |
| Participant contributions | — | — | 4.6 | 3.7 |
| Benefits paid | (36.2) | (35.2) | (16.9) | (19.2) |
| Acquired businesses and plan amendments | 7.9 | 10.3 | (8.8) | (44.4) |
| Change in discount rate and other | 8.5 | 25.5 | 4.9 | (3.8) |
| Benefit obligation — end of year | $ 536.6 | $ 526.2 | $ 102.6 | $ 112.5 |
| Projected salary increases | 26.1 | 22.4 | — | — |
| Accumulated benefit obligation | $ 510.5 | $ 503.8 | $ 102.6 | $ 112.5 |
| Change in plan assets: | | | | |
| Plan assets — beginning of year | $ 377.6 | $ 309.0 | $ — | $ — |
| Actual return on plan assets | 23.9 | 27.0 | — | — |
| Company contributions | 5.5 | 73.6 | 12.3 | 15.5 |
| Plan participants' contributions | — | — | 4.6 | 3.7 |
| Benefits paid | (36.2) | (35.2) | (16.9) | (19.2) |
| Other | (0.8) | 3.2 | — | — |
| Plan assets — end of year | $ 370.0 | $ 377.6 | $ — | $ — |
| Funded status: | | | | |
| Projected benefit obligation in excess of plan assets | $(166.6) | $(148.6) | $(102.6) | $(112.5) |
| Unrecognized prior service cost | (0.6) | (0.7) | (47.6) | (42.7) |
| Unrecognized net actuarial loss | 196.2 | 190.8 | 33.4 | 29.9 |
| Net amount recognized | $ 29.0 | $ 41.5 | $(116.8) | $(125.3) |

Amounts included in the Consolidated Balance Sheets are as follows:

| | Pension Benefits | | Health Care Benefits | |
|---|---|---|---|---|
| (In millions) | 2005 | 2004 | 2005 | 2004 |
| Accrued benefit cost, net | $(140.2) | $(125.6) | $(116.8) | $(125.3) |
| Intangible assets | 0.1 | 0.2 | — | — |
| Minimum Pension liability included in accumulated other comprehensive income | 169.1 | 166.9 | — | — |
| Net amount recognized | $ 29.0 | $ 41.5 | $(116.8) | $(125.3) |

Table of Contents

As of December 31, 2005 and 2004, PolyOne had plans with a Projected Benefit Obligation and an Accumulated Benefit Obligation in excess of the related plan assets. Information for these plans is presented below:

| | Pension Benefits | |
|---|---|---|
| (In millions) | 2005 | 2004 |
| Projected benefit obligation | $534.2 | $523.3 |
| Accumulated benefit obligation | 508.1 | 501.2 |
| Fair value of plan assets | 366.6 | 374.2 |

| | Pension Benefits | | | Health Care Benefits | | |
|---|---|---|---|---|---|---|
| | 2005 | 2004 | 2003 | 2005 | 2004 | 2003 |
| Weighted-average assumptions used to determine benefit obligation at December 31: | | | | | | |
| Discount rate | 5.66% | 5.58% | 6.25% | 5.56% | 5.43% | 6.25% |
| Rate of compensation increase | 3.5% | 3.5% | 3.5% | — | — | — |
| Assumed health care cost trend rates at December 31: | | | | | | |
| Health care cost trend rate assumed for next year | — | — | — | 11% | 11% | 11% |
| Rate to which the cost trend rate is assumed to decline (the ultimate trend rate) | — | — | — | 5.25% | 5.25% | 5.25% |
| Year that the rate reaches the ultimate trend rate | — | — | — | 2012 | 2011 | 2010 |

An expected return on plan assets of 8.50% will be used to calculate the 2006 pension expense. The expected long-term return rate on pension assets was determined after considering the historical experience of long-term asset returns by asset category, the expected investment portfolio mix by category of asset and estimated future long-term investment returns.

The following table summarizes the components of net period benefit cost that was recognized during each of the years in the three-year period ended December 31, 2005. Actuarial assumptions that were used are also included.

| | Pension Benefits | | | Health Care Benefits | | |
|---|---|---|---|---|---|---|
| (Dollars in millions) | 2005 | 2004 | 2003 | 2005 | 2004 | 2003 |
| Components of net periodic benefit costs: | | | | | | |
| Service cost | $ 1.3 | $ 1.1 | $ 1.4 | $ 0.4 | $ 0.5 | $ 0.8 |
| Interest cost | 28.9 | 29.6 | 30.0 | 5.9 | 8.2 | 10.2 |
| Expected return on plan assets | (31.7) | (26.3) | (21.7) | — | — | — |
| Curtailment and settlement charges | 0.4 | 0.1 | 0.2 | — | — | 0.1 |
| Amortization of unrecognized (gains) or losses, transition obligation and prior service cost | 13.0 | 10.7 | 13.8 | (3.3) | (0.8) | 0.8 |
| | $ 11.9 | $ 15.2 | $ 23.7 | $ 3.0 | $ 7.9 | $11.9 |

| | Pension Benefits | | | Health Care Benefits | | |
|---|---|---|---|---|---|---|
| | 2005 | 2004 | 2003 | 2005 | 2004 | 2003 |
| Weighted-average assumptions used to determine net period benefit cost for the years ended December 31: | | | | | | |
| Discount rate | 5.58% | 6.25% | 6.75% | 5.43% | 6.25% | 6.75% |
| Expected long-term return on plan assets | 8.75% | 8.75% | 8.75% | — | — | — |
| Rate of compensation increase | 3.5% | 3.5% | 4.0- 7.0% | — | — | — |
| Assumed health care cost trend rates at December 31: | | | | | | |
| Health care cost trend rate assumed for next year | — | — | — | 10% | 10% | 10% |
| Rate to which the cost trend rate is assumed to decline (the ultimate trend rate) | — | — | — | 5.25% | 5.25% | 5.25% |
| Year that the rate reaches the ultimate trend rate | — | — | — | 2011 | 2010 | 2009 |

Assumed health care cost trend rates have an effect on the amounts reported for the health care plans. A one-percentage-point change in assumed health care cost trend rates would have the following impact:

| (In millions) | 1-Percentage-Point Increase | 1-Percentage-Point Decrease |
|---|---|---|
| Effect on total of service and interest cost | $0.4 | $(0.3) |
| Effect on post-retirement benefit obligation | 6.9 | (6.2) |

PolyOne's pension asset investment strategy is to diversify the asset portfolio among and within asset categories to enhance the portfolio's risk-adjusted return. PolyOne's expected portfolio asset mix also considers the duration of the plan liabilities and gives more weight to equity positions than to fixed income securities. PolyOne's pension asset investment allocation guidelines are to invest 60% to 75% in equity securities and 25% to 40% in debt securities (including cash equivalents). PolyOne's weighted-average asset allocations at December 31, 2005 and 2004 were as follows:

| | Plan Assets at December 31, | |
|---|---|---|
| Asset Category | 2005 | 2004 |
| Equity securities | 63% | 67% |
| Debt securities | 36 | 29 |
| Other | 1 | 4 |
| | 100% | 100% |

The estimated future benefit payments for PolyOne's pension and health care plans are as follows:

| (In millions) | Pension Benefits | Health Care Benefits | Medicare Part D Subsidy |
|---|---|---|---|
| 2006 | $ 34.5 | $ 8.9 | $1.4 |
| 2007 | 34.3 | 9.2 | 1.4 |
| 2008 | 34.4 | 9.3 | 1.6 |
| 2009 | 34.5 | 9.4 | 1.7 |
| 2010 | 35.1 | 9.3 | 1.7 |
| 2011 through 2015 | 180.5 | 43.6 | 8.8 |

The Company's estimate of 2006 employer contributions is $4.8 million to all qualified and nonqualified pension plans and $8.9 million to all health care benefit plans. The Company does not anticipate any minimum funding requirements for its U.S. qualified defined-benefit plans in 2006.

PolyOne sponsors a voluntary retirement savings plan (RSP). Under the provisions of this plan, eligible employees can generally receive Company matching contributions up to the first 6% of their eligible earnings. In addition, PolyOne may make discretionary contributions to this plan for eligible employees based on a specific percentage of each employee's compensation. Following are PolyOne's contributions to the RSP:

| (In millions) | 2005 | 2004 | 2003 |
|---|---|---|---|
| Retirement savings match | $5.1 | $4.2 | $ 7.8 |
| Defined retirement benefit | 4.8 | 5.4 | 4.2 |
| | $9.9 | $9.6 | $12.0 |

**Note N – COMMITMENTS AND RELATED-PARTY INFORMATION**

**Environmental** - PolyOne has been notified by 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 a number of environmental waste disposal sites. While government agencies frequently assert that PRPs are jointly and severally liable at these sites, in PolyOne's experience 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. Based on estimates prepared by its environmental engineers and consultants, PolyOne had accruals totaling $55.2 million at December 31, 2005 and $64.5 million at December 31, 2004 to cover probable future environmental expenditures relating 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 accrued amount at December 31, 2005. However, such additional costs, if any, cannot be currently estimated. PolyOne's estimate of this liability may be revised as new regulations or technologies are developed or additional information is obtained. For 2005, 2004 and 2003, PolyOne incurred environmental expense of $0.2 million, $10.3 million and $4.1 million, respectively, of which $0.9 million in 2005, $8.7 million in 2004 and $2.7 million in 2003 relates to inactive or formerly owned sites. Environmental expense is presented net of insurance recoveries of $2.2 million in 2005, $1.8 million in 2004 and $0.1 million in 2003.

**Guarantees** - PolyOne guarantees $73.1 million of SunBelt's outstanding senior secured notes in connection with the construction of a chlor-alkali facility in Macintosh, Alabama. This debt guarantee matures in 2017.

**Related-Party Transactions** - PolyOne purchases a substantial portion of its PVC resin and all of its VCM raw materials under supply agreements with OxyVinyls. These agreements have an initial term of 15 years commencing May 1, 1999, and PolyOne has the right to renew these agreements for two five-year periods. PolyOne has also entered into various service agreements with OxyVinyls. Net amounts owed to OxyVinyls, primarily for raw material purchases, totaled $28.0 million at December 31, 2005 and $22.5 million at December 31, 2004. PolyOne's purchases of raw materials from OxyVinyls were $352 million during 2005, $264 million during 2004 and $230 million during 2003.

**Note O – OTHER EXPENSE, NET**

| (In millions) | 2005 | 2004 | 2003 |
|---|---|---|---|
| Currency exchange loss, net of foreign exchange contracts | $ 0.5 | $ (4.1) | $ (5.0) |
| Discount on sale of trade receivables | (5.5) | (6.1) | (5.9) |
| Retained post-employment benefit cost related to previously discontinued business operations | (1.3) | (3.6) | (3.0) |
| Premium on debt repurchase | — | (3.3) | — |
| Other income, net | 1.0 | 0.6 | 0.6 |
| | $(5.3) | $(16.5) | $(13.3) |

**Note P – Income Taxes**

Income (loss) before income taxes and discontinued operations consists of the following:

| (In millions) | 2005 | 2004 | 2003 |
|---|---|---|---|
| Domestic | $52.6 | $(10.9) | $(123.6) |
| Foreign | 16.2 | 52.2 | 29.7 |
| | $68.8 | $ 41.3 | $ (93.9) |

A summary of income tax expense follows:

| (In millions) | 2005 | 2004 | 2003 |
|---|---|---|---|
| Current: | | | |
| Federal | $0.3 | $ — | $ — |
| State | 0.7 | 0.4 | — |
| Foreign | 3.6 | 12.6 | 7.8 |
| Total current | $4.6 | $13.0 | $ 7.8 |
| Deferred: | | | |
| Federal | — | — | — |
| State | — | — | — |
| Foreign | 2.0 | 0.7 | 4.7 |
| Total deferred | $2.0 | $ 0.7 | $ 4.7 |
| Total tax expense | $6.6 | $13.7 | $12.5 |

The income tax rate (benefit) for financial reporting purposes differed from the federal statutory rate as follows:

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| Federal statutory income tax rate | 35.0% | 35.0% | (35.0)% |
| Alternative minimum tax | 0.4 | — | — |
| State tax, net of federal benefit | 0.7 | 0.7 | (3.3) |
| Valuation allowance | (31.0) | 12.5 | 25.0 |
| Provision for repatriation of foreign earnings | 2.0 | — | 25.1 |
| Differences in rates of foreign operations | (0.1) | (12.1) | 2.2 |
| Other, net | 2.6 | (2.9) | (0.7) |
| Effective income tax rate | 9.6% | 33.2% | 13.3% |

Components of PolyOne's deferred tax liabilities and assets at December 31, 2005 and 2004 were as follows:

| (In millions) | 2005 | 2004 |
|---|---|---|
| Deferred tax liabilities: | | |
| Tax over book depreciation | $ 52.2 | $ 58.2 |
| Intangibles | 4.8 | 4.6 |
| Equity investments | 131.0 | 149.1 |
| Other, net | 6.0 | 8.6 |
| Total deferred tax liabilities | $194.0 | $220.5 |
| Deferred tax assets: | | |
| Post-retirement benefits other than pensions | $ 38.6 | $ 41.0 |
| Employment cost and pension | 44.5 | 42.5 |
| Discontinued operations impairment | 15.7 | 14.7 |
| Employee separation and plant phaseout | 2.1 | 2.3 |
| Environmental | 19.4 | 22.4 |
| Net operating loss carryforward | 146.6 | 171.0 |
| State taxes | 5.9 | 5.9 |
| Alternative minimum tax credit carryforward | 6.1 | 5.8 |
| Foreign net operating losses and tax credit carryforward | 1.2 | 6.6 |
| Other, net | 11.1 | 24.1 |
| Total deferred tax assets | $291.2 | $336.3 |
| Tax valuation allowance | (76.9) | (95.5) |
| Net deferred tax assets | $ 20.3 | $ 20.3 |

The reduction in the valuation allowance in 2005 is primarily the result of utilizing net operating loss carryforwards.

SFAS No. 109, "Accounting for Income Taxes," requires that deferred tax assets be determined for each tax-paying component of an enterprise within each tax jurisdiction. The deferred tax assets presented in the table above are primarily attributable to tax jurisdictions where a recent history of losses has occurred. Therefore, PolyOne believes that a valuation allowance is required to reduce the deferred tax asset to an amount that is more likely than

not to be realized. PolyOne intends to maintain its valuation allowance until sufficient positive evidence exists to support realization of the deferred tax assets.

PolyOne provided for U.S. federal and foreign withholding tax on $22.0 million, or 10% of foreign subsidiaries' undistributed earnings as of December 31, 2005. Undistributed earnings for which no federal or foreign withholding tax has been provided are intended to be reinvested indefinitely. The amount of income tax liability that would result if these earnings actually had been repatriated cannot be determined.

PolyOne paid income taxes, net of refunds, of $10.2 million in 2005, $8.0 million in 2004 and $7.9 million in 2003. PolyOne has a U.S. net operating loss carryforward of $418.8 million, of which $28.6 million will expire in 2018, $3.5 million in 2019, $9.5 million in 2020, $106.3 million in 2021, $98.0 million in 2022, $87.1 million in 2023 and the remaining $85.8 million in 2024. In addition, PolyOne has an alternative minimum tax credit carryforward of $6.1 million that has no expiration date.

**Note Q – SHAREHOLDERS' EQUITY**

In May 2005, PolyOne's shareholders approved the 2005 Equity and Performance Incentive Plan (2005 EPIP). All future grants and awards will only be issued from the 2005 EPIP. As a result, all previous equity-based plans were frozen in May 2005. The 2005 EPIP will be administered by the Board of Directors, which may delegate all or any part of its authority from time to time under the 2005 EPIP to the Compensation and Governance Committee of the Board of Directors. Officers, employees and non-employee directors are eligible to participate. The 2005 EPIP provides for the award of a broad variety of stock-based compensation alternatives such as non-qualified stock options, incentive stock options, restricted stock, performance awards and stock appreciation rights. A total of five million shares have been approved for future grants and awards under the 2005 EPIP.

A summary of stock option activity follows:

| (In thousands, except per share data) | Shares | Weighted-Average Exercise Price |
|---|---|---|
| Outstanding at December 31, 2002 | 13,054 | $12.16 |
| Issued | 1,462 | 6.00 |
| Exercised | — | — |
| Forfeited | (2,057) | 10.89 |
| Outstanding at December 31, 2003 | 12,459 | $11.65 |
| Issued | 109 | 7.08 |
| Exercised | (43) | 7.78 |
| Forfeited | (2,149) | 10.85 |
| Outstanding at December 31, 2004 | 10,376 | 11.79 |
| Issued | — | — |
| Exercised | (71) | 8.03 |
| Forfeited | (1,190) | 14.10 |
| Outstanding at December 31, 2005 | 9,115 | 11.55 |
| Exercisable at December 31, 2005 | 8,834 | 11.73 |
| Exercisable at December 31, 2004 | 9,302 | 12.16 |
| Exercisable at December 31, 2003 | 9,512 | 12.60 |
| At December 31, 2005: | | |
| Exercisable options: | | |
| Exercise price: $3.60 - $13.00 | 6,923 | $10.01 |
| Exercise price: $13.01 - $26.82 | 1,911 | 17.96 |
| Unexercisable options: | | |
| Exercise price: $3.60 - $13.00 | 281 | $ 6.01 |
| Exercise price: $13.01 - $26.82 | — | — |

At December 31, 2005, the weighted-average remaining life of options with an exercise price of $13.00 or less was 3.8 years. Options with an exercise price of more than $13.00 had a weighted-average remaining life of 2.7 years. Approximately 10.6 million shares remain outstanding at December 31, 2005 that can be issued in the future when the previously granted stock options have been exercised.

Compensation cost that was recognized for the stock portion of the annual incentive plans, three-year incentive plan and amortization of restricted stock that was awarded was $0.5 million in 2005, $0.1 million in 2004 and $1.4 million in 2003. The weighted-average fair value per share of stock awards under the long-term incentive plan on the grant date was $8.94 for 2005, $6.00 for 2004 and $6.13 for 2003.

On December 10, 2003, the Compensation and Governance Committee of PolyOne's Board of Directors approved grants under the Incentive Plan that were effective December 11, 2003. Target-Priced Stock Appreciation Rights (SARs) totaling 1.3 million shares were granted with an exercise term of 36 months. Vesting is contingent upon attaining target prices of $8.00, $9.00, and

$10.00 of PolyOne's common stock. PolyOne recorded compensation expense of $2.6 million in 2004 for these SARs and a benefit of $1.3 million in 2005.

In January 2005, the Compensation and Governance Committee of PolyOne's board of directors authorized the issuance of 639,300 performance shares and 474,300 SARs. The performance shares vest 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 are achieved for the period commencing January 1, 2005 and ending December 31, 2007. If these three goals are attained, the performance shares will be awarded no later than March 15, 2008. The value of the SARs was $3.84 per share and was calculated using the Black-Scholes-Merton valuation method. The SARs will be issued for shares of PolyOne common stock and will vest in one-third increments when PolyOne's stock price increases by 10%, 20%, and 30% above the $8.94 base price. The SARs have a seven-year exercise period that expires on January 4, 2012.

In January 2006, the Compensation and Governance Committee of PolyOne's board of directors authorized the issuance of 854,400 SARs at a price of $6.51. The value of these SARs was $2.64 per share and was calculated using a binomial valuation method. These SARs will be issued for shares of PolyOne common stock and will vest in one-third increments when PolyOne's stock price reaches $7.50, $8.50 and $10.00 per share. The exercise period of the SARs is seven years and ends on January 3, 2013.

**Note R – SEGMENT INFORMATION**

A segment is a component of an enterprise whose operating results are regularly reviewed by the enterprise's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance, and for which discrete financial information is available.

PolyOne determines and discloses its segments in accordance with SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," which uses a "management" approach for determining segments. The management approach designates the internal organization that is used by management for making operating decisions and assessing performance to determine PolyOne's reportable segments. As required by SFAS No. 131, the product groups within each segment have similar economic characteristics and future prospects, and contain similar products, production processes, types of customers, methods of distribution and regulatory requirements.

PolyOne manages its business in three reportable segments: Performance Plastics, Distribution, and Resins and Intermediates. PolyOne's chief operating decision makers use the volume of product sold (pounds or kilograms), sales, operating income, assets and operating income return on assets for each segment to make operating decisions and assess performance.

PolyOne sold its Elastomers and Performance Additives business in August 2004. It was previously reported as a separate segment, and its historic financial results are presented as discontinued operations. PolyOne sold its Engineered Films business in February 2006. It was previously included in the Performance Plastics segment, and its historic financial results are also presented as discontinued operations. The Specialty Resins business, previously held for sale and presented as discontinued operations, was reclassified in the fourth quarter of 2005 to continuing operations for all historic periods presented as of December 31, 2005 when management determined that the divestment process was unlikely to result in a sale of the business at acceptable terms.

The accounting policies of each segment are consistent with those described in Note C, "Summary of Significant Accounting Policies." Segment assets are primarily customer receivables, inventories, net property, plant and equipment, and goodwill. Intersegment sales are accounted for at prices that approximate those for similar transactions with unaffiliated customers. The Other segment includes the elimination of intersegment sales, certain unallocated corporate expenses, including corporate expenses previously allocated to discontinued operations, cash, sales of accounts receivable, retained assets and liabilities of discontinued operations and other unallocated corporate assets.

*Performance Plastics* - The Performance Plastics segment manufactures polymer-related products in the following product groups:

- Vinyl Compounds - Vinyl, or PVC, is a highly versatile plastic. It can be made thin and flexible enough for intravenous solution bags, yet rigid and tough enough for window and computer housings. Because of this versatility, vinyl is one of the most widely used plastics, utilized in a range of applications. PolyOne's vinyl compounds combine PVC resins with a broad range of additives that provide product versatility, particularly when fire resistance, chemical resistance or weatherability is required.
- Colors and Additives - Color and additive concentrates, or masterbatches, are plastic compounds that contain a high concentration of color pigments or additives predispersed in a polymer carrier medium and supplied in pellet, liquid, flake or powder form. Color masterbatches are used with the base resin mix so that the correct color or additive performance is achieved. Additive masterbatches include a wide variety of products, but are commonly categorized by the function performed, such as UV stabilizers, slip/antiblock, antistat, blowing agents, antioxidants, lubricants, and stabilizers. PolyOne's color and additive masterbatches provide flexibility to plastic processors who prefer to create multiple color effects or enhance the performance of their own base polymers. PolyOne's colors and additives for thermoplastics are used throughout the plastic industry, particularly in the outdoor decking, packaging, automotive, consumer, pipe,

and wire and cable industries. PolyOne's colors and additives are also incorporated into end-use products such as stadium seating, toys, housewares, vinyl siding, pipe, food packaging, and medical packaging.

- Engineered Materials - PolyOne's engineered materials consist of reinforced and filled plastic compounds and thermoplastic elastomer compounds. With PolyOne's compounding expertise, it has the ability to expand the performance range and structural properties of traditional engineering-grade thermoplastic resins. PolyOne combines its knowledge of base polymers, lubricants, fillers and reinforcements and a wide range of functional additives to tailor its compounds to meet its customers' unique application requirements. PolyOne's compounds incorporate commodity resins such as polyethylene and polypropylene, and engineering resins such as nylon, polycarbonate and polyesters. In addition, PolyOne has a broad product line of thermoplastic elastomer compounds, including thermoplastic olefins, thermoplastic vulcanizates and styrene block copolymers.

- Polymer Coating Systems - Polymer coating systems products consist primarily of liquid systems with a base resin of specialty vinyl resin, natural rubber latex or polyurethane resin. Products also include proprietary PVC screen printing inks and powders, latex, specialty additives and colorants that meet the specific needs of customers' applications. Applications for polymer coating system products include: inks for textiles in the consumer industry; armrests, headrests and oil filters in the automotive industry; coil coatings, sheet vinyl and carpet backing in the construction industry; and decals, coatings and tool handles for general industry.

- Specialty Resins - Specialty resins are usually compounded in a liquid form for flexible product applications and are largely customized to specific end-use applications. Specialty vinyl resins are used in products such as vinyl flooring, carpeting, automotive instrument and door panels, coated fabrics, medical examination gloves and foam products.

*Distribution* - The Distribution segment distributes more than 3,500 grades of engineering and commodity grade resins and compounds to the North American market, including PolyOne-produced products. The Company purchases bulk quantities of base plastic resins, such as polycarbonate, polyethylene, polypropylene and polystyrene from approximately 20 major suppliers and resells them in truckload and less-than-truckload quantities to more than 5,000 customers throughout North America. These products are sold to custom molders and extruders who, in turn, convert them into plastic products sold to a number of different industries and end-use markets. The Distribution segment ships approximately 640 million pounds of product annually from more than 30 stocking locations, including ten repackaging plants across North America.

*Resin and Intermediates* - The Resin and Intermediates segment consists almost entirely of two joint ventures that are reported on the equity method. OxyVinyls is a 24% owned producer of PVC resin, VCM, chlorine and caustic soda, and SunBelt is a 50% owned producer of chlorine and caustic soda. OxyVinyls is PolyOne's principal supplier of PVC resin.

| (In millions) | Total | Performance Plastics | Distribution | Resin and Intermediates | Other |
|---|---|---|---|---|---|
| Year ended December 31, 2005: | | | | | |
| Sales to external customers | $2,450.6 | $1,778.7 | $671.9 | $ — | $ — |
| Intersegment sales | — | 146.7 | 7.3 | — | (154.0) |
| | $2,450.6 | $1,925.4 | $679.2 | $ — | $(154.0) |
| Operating income (loss) | $ 140.3 | $ 62.8 | $ 19.5 | $ 67.1 | $ (9.1) |
| Expenses included in operating income: | | | | | |
| Employee separation and plant phaseout charges | $ 5.5 | $ 2.4 | $ — | $ — | $ 3.1 |
| Environmental remediation costs at inactive sites | 0.9 | 0.6 | — | 2.9 | (2.6) |
| Asset impairments | 0.4 | — | — | — | 0.4 |
| Depreciation and amortization | $ 50.7 | $ 46.7 | $ 1.3 | $ 0.2 | $ 2.5 |
| Total assets | $1,716.0 | $1,115.6 | $176.9 | $259.9 | $ 163.6 |
| Capital expenditures | $ 32.1 | $ 25.9 | $ 0.3 | $ — | $ 5.9 |

| (In millions) | Total | Performance Plastics | Distribution | Resin and Intermediates | Other |
|---|---|---|---|---|---|
| Year ended December 31, 2004: | | | | | |
| Sales to external customers | $2,267.7 | $1,667.9 | $599.8 | $ — | $ — |
| Intersegment sales | — | 135.8 | 6.5 | — | (142.3) |
| | $2,267.7 | $1,803.7 | $606.3 | $ — | $(142.3) |
| Operating income (loss) | $ 128.4 | $ 83.5 | $ 17.8 | $ 49.2 | $ (22.1) |
| Expenses (benefits) included in operating income: | | | | | |
| Employee separation and plant phaseout (benefit) charges | $ (1.4) | $ (1.8) | $ — | $ — | $ 0.4 |
| Environmental remediation costs at inactive sites | 8.7 | — | — | — | 8.7 |
| Loss on sale of assets | 5.9 | 5.9 | — | — | — |
| Asset impairments | 3.8 | 3.3 | — | — | 0.5 |
| Depreciation and amortization | $ 50.9 | $ 48.3 | $ 1.3 | $ 0.2 | $ 1.1 |
| Total assets | $1,774.8 | $1,163.1 | $160.7 | $247.7 | $ 203.3 |
| Capital expenditures | $ 23.9 | $ 23.0 | $ 0.1 | $ — | $ 0.8 |

| (In millions) | Total | Performance Plastics | Distribution | Resin and Intermediates | Other |
|---|---|---|---|---|---|
| Year ended December 31, 2003: | | | | | |
| Sales to external customers | $2,048.1 | $1,525.4 | $522.7 | $ — | $ — |
| Intersegment sales | — | 114.7 | 6.5 | — | (121.2) |
| | $2,048.1 | $1,640.1 | $529.2 | $ — | $(121.2) |
| Operating income (loss) | $ (14.9) | $ (7.2) | $ 5.8 | $ 20.8 | $ (34.3) |
| Expenses included in operating income: | | | | | |
| Employee separation and plant phaseout charges | $ 35.7 | $ 25.2 | $ 1.6 | $ — | $ 8.9 |
| Environmental remediation costs at inactive sites | 2.7 | — | — | — | 2.7 |
| Loss on sale of assets | 0.3 | — | — | — | 0.3 |
| Asset impairments | 19.4 | 16.4 | — | 1.4 | 1.6 |
| Depreciation and amortization | $ 57.7 | $ 54.5 | $ 1.6 | $ 0.2 | $ 1.4 |
| Total assets | $1,900.9 | $1,236.7 | $138.8 | $240.0 | $ 285.4 |
| Capital expenditures | $ 29.4 | $ 27.9 | $ 0.6 | $ — | $ 0.9 |

Table of Contents

Sales by product group for the years ended December 31, 2005 and 2004 and the changes versus the prior year are as follows:

| | Year Ended December 31, 2005 vs. 2004 | | | Year Ended December 31, 2004 vs. 2003 | | |
|---|---|---|---|---|---|---|
| | 2005 Sales $ | 2005 Sales $ | 2005 Shipment Pounds | 2004 Sales $ | 2004 Sales $ | 2004 Shipment Pounds |
| | % of Total | % Change vs. 2004 | % Change vs. 2004 | % of Total | % Change vs. 2003 | % Change vs. 2003 |
| Vinyl Compounds | 40% | 8% | (4)% | 40% | 12% | 9% |
| North American Colors and Additives | 13% | 8% | 3% | 13% | 12% | 23% |
| North American Engineered Materials | 6% | 0% | (7)% | 6% | 4% | (10)% |
| International Colors and Engineered Materials | 25% | 2% | (11)% | 26% | 8% | (9)% |
| Polymer Coating Systems | 9% | 2% | (6)% | 9% | 2% | (3)% |
| Specialty Resins | 7% | 29% | (3)% | 6% | 26% | 19% |
| Total Performance Plastics | 100% | 7% | (5)% | 100% | 10% | 4% |

Earnings of equity affiliates are included in the related segment's operating income and the investment in equity affiliates is included in the related segment's assets. Amounts related to equity affiliates included in the segment information, excluding amounts related to losses on divestitures of equity investments, are as follows:

| (In millions) | 2005 | 2004 | 2003 |
|---|---|---|---|
| Earnings of equity affiliates: | | | |
| Performance Plastics | $ 6.5 | $ 5.9 | $ 4.2 |
| Resin and Intermediates | 72.4 | 60.3 | 32.1 |
| Subtotal | 78.9 | 66.2 | 36.3 |
| Minority interest | — | (1.5) | (1.8) |
| Total | $ 78.9 | $ 64.7 | $ 34.5 |
| Investment in equity affiliates: | | | |
| Performance Plastics | $ 25.0 | $ 26.4 | $ 27.9 |
| Resin and Intermediates | 248.9 | 236.9 | 228.8 |
| Total | $273.9 | $263.3 | $256.7 |

PolyOne's sales are primarily to customers in the United States, Europe, Canada and Asia, and the majority of its assets are located in these same geographic areas. Following is a summary of sales and long-lived assets based on the geographic areas where the sales originated and where the assets are located:

| (In millions) | 2005 | 2004 | 2003 |
|---|---|---|---|
| Net sales: | | | |
| United States | $1,647.0 | $1,500.9 | $1,337.2 |
| Europe | 405.4 | 418.5 | 392.3 |
| Canada | 283.2 | 254.4 | 227.1 |
| Asia | 101.5 | 81.4 | 72.0 |
| Other | 13.5 | 12.5 | 19.5 |
| Long-lived assets: | | | |
| United States | $ 627.8 | $ 664.1 | $ 688.6 |
| Europe | 104.5 | 97.4 | 116.9 |
| Canada | 63.4 | 62.9 | 59.0 |
| Asia | 23.5 | 42.6 | 41.0 |
| Other | 2.7 | 2.7 | 3.1 |

**Note S – WEIGHTED-AVERAGE SHARES USED IN COMPUTING EARNINGS PER SHARE**

| (In millions) | 2005 | 2004 | 2003 |
|---|---|---|---|
| Weighted-average shares – basic: | | | |
| Weighted-average shares outstanding | 91.9 | 91.6 | 91.7 |
| Less unearned portion of restricted stock awards included in outstanding shares | — | — | (0.6) |
| | 91.9 | 91.6 | 91.1 |
| Weighted-average shares – diluted: | | | |
| Weighted-average shares outstanding – basic | 91.9 | 91.6 | 91.1 |
| Plus dilutive impact of stock options and stock awards | 0.1 | 0.2 | — |
| | 92.0 | 91.8 | 91.1 |

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

PolyOne excluded all outstanding options from the calculation of diluted loss per share in 2003 because they would have had an anti-dilutive effect due to the net loss and exercise prices that were greater than the average market price of its common shares.

**Note T – FINANCIAL INSTRUMENTS**

PolyOne enters into intercompany lending transactions denominated in various foreign currencies and is subject to financial exposure from foreign exchange rate movement from the date a loan is recorded to the date it is settled or revalued. To mitigate this risk, PolyOne enters into foreign exchange contracts. Gains and losses on these contracts generally offset gains or losses on the assets and liabilities being hedged and are recorded as other income or expense in the Consolidated Statements of Operations. PolyOne does not hold or issue financial instruments for trading purposes.

The following table summarizes the contractual amounts of PolyOne's foreign exchange contracts at December 31, 2005 and 2004. Foreign currency amounts are translated at exchange rates as of December 31, 2005 and 2004, respectively. The "Buy" amounts represent the U.S. dollar equivalent of commitments to purchase foreign currencies, and the "Sell" amounts represent the U.S. dollar equivalent of commitments to sell foreign currencies.

| | December 31, 2005 | | December 31, 2004 | |
|---|---|---|---|---|
| **Currency (in millions)** | **Buy** | **Sell** | **Buy** | **Sell** |
| U.S. dollar | $88.2 | $57.8 | $129.4 | $ 89.0 |
| Euro | 12.7 | 86.9 | 45.4 | 131.9 |
| British pound sterling | 8.3 | — | — | 0.8 |
| Canadian dollar | 32.1 | — | 33.7 | — |
| Other | 3.9 | — | 11.6 | — |

PolyOne used the following methods and assumptions to estimate the fair value of financial instruments:

**Cash and cash equivalents** – The carrying amounts approximate fair value.

**Long- and short-term debt** – The carrying amounts of PolyOne's short-term borrowings approximate fair value. The fair value of PolyOne's senior notes, debentures and medium-term notes is based on quoted market prices. The carrying amount of PolyOne's borrowings under its variable-interest rate revolving credit agreements and other long-term borrowings approximates fair value.

**Foreign exchange contracts** – The fair value of short-term foreign exchange contracts is based on exchange rates at December 31, 2005. The fair value of long-term foreign exchange contracts is based on quoted market prices for contracts with similar maturities.

**Interest rate swaps** – The fair value of interest rate swap agreements, obtained from the respective financial institutions, is based on current rates of interest and is computed as the net present value of the remaining exchange obligations under the terms of the contract.

The carrying amounts and fair values of PolyOne's financial instruments at December 31, 2005 and 2004 are as follows:

| | 2005 | | 2004 | |
|---|---|---|---|---|
| **(In millions)** | **Carrying Amount** | **Fair Value** | **Carrying Amount** | **Fair Value** |
| Cash and cash equivalents | $ 32.8 | $ 32.8 | $ 38.6 | $ 38.6 |
| Long-term debt | | | | |
| 6.875% debentures | — | — | 29.2 | 27.6 |
| 10.625% senior notes | 300.0 | 324.7 | 300.0 | 337.5 |
| 7.500% debentures | 50.0 | 45.1 | 50.0 | 38.8 |
| 8.875% senior notes | 198.9 | 199.0 | 198.7 | 217.5 |
| Medium-term notes | 90.5 | 94.9 | 110.3 | 101.7 |
| Bank borrowings | — | — | 1.5 | 1.6 |
| Foreign exchange contracts | 0.6 | 0.6 | (1.5) | (1.5) |
| Interest rate swaps | (5.8) | (5.8) | (3.6) | (3.6) |

Table of Contents

**Note U – SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)**

| | 2005 Quarters | | | | 2004 Quarters | | | |
|---|---|---|---|---|---|---|---|---|
| (In millions, except per share data) | Fourth | Third | Second | First | Fourth | Third | Second | First |
| Sales | $ 606.8 | $ 611.6 | $ 620.4 | $ 611.8 | $ 544.5 | $ 579.3 | $ 584.9 | $ 559.0 |
| Operating costs and expenses, net | 568.8 | 607.2 | 567.2 | 567.1 | 526.8 | 539.0 | 541.6 | 531.9 |
| Operating income | 38.0 | 4.4 | 53.2 | 44.7 | 17.7 | 40.3 | 43.3 | 27.1 |
| Income (loss) before discontinued operations | 20.4 | (16.2) | 33.0 | 25.0 | (8.8) | 14.3 | 21.4 | 0.7 |
| Discontinued operations | 1.3 | (3.3) | (1.7) | (11.6) | (4.8) | (2.7) | 0.1 | 3.3 |
| Net income (loss) | $ 21.7 | $ (19.5) | $ 31.3 | $ 13.4 | $ (13.6) | $ 11.6 | $ 21.5 | $ 4.0 |
| Basic and diluted earnings (loss) per share: (1) | | | | | | | | |
| Before discontinued operations | $ 0.22 | $ (0.18) | $ 0.36 | $ 0.27 | $ (0.10) | $ 0.16 | $ 0.23 | $ 0.01 |
| Net income (loss) | $ 0.24 | $ (0.21) | $ 0.34 | $ 0.15 | $ (0.15) | $ 0.13 | $ 0.23 | $ 0.04 |

(1) Per share amounts for the quarter and the full year have been computed separately. The sum of the quarterly amounts may not equal the annual amounts presented because of differences in the average shares outstanding during each period.

The quarterly amounts for 2005 and 2004 have been restated to reflect the reclassification of the Specialty Resins business from discontinued operations to continuing operations as of December 31, 2005.

**Note V – SUBSEQUENT EVENTS**

On February 15, 2006, PolyOne sold 82% of its Engineered Films business to an investor group consisting of members of the business unit’s management team and Matrix Films, LLC for gross proceeds of $26.7 million. A cash payment of $20.5 million was received on the closing date and the remaining $6.2 million was in the form of a five-year note from the buyer. This business is presented in discontinued operations in these financial statements. PolyOne retained an 18% ownership interest in the business, which will be reported on the cost method of accounting.

Table of Contents

## SCHEDULE II

### POLYONE CORPORATION AND SUBSIDIARIES
### SCHEDULE II – VALUATION AND QUALIFYING ACCOUNTS
### FOR THE YEARS ENDED DECEMBER 31, 2005, 2004 AND 2003
### (In millions)

| | Balance at Beginning of Period | Charged to Costs and Expenses | Charged to Other Accounts(C) | Other Deductions | Other Additions | Balance at End of Period |
|---|---|---|---|---|---|---|
| Year ended December 31, 2005 | | | | | | |
| Reserves for doubtful accounts | $ 8.0 | $ 2.8 | $ — | $(4.4) (A) | $ — | $ 6.4 |
| Accrued liabilities for environmental matters | $64.5 | $ 0.2 | $0.3 | $(9.8) (B) | $ — | $55.2 |
| Year ended December 31, 2004 | | | | | | |
| Reserves for doubtful accounts | $10.4 | $ 1.5 | $ — | $(3.9) (A) | $ — | $ 8.0 |
| Accrued liabilities for environmental matters | $54.7 | $10.3 | $1.6 | $(2.1) (B) | $ — | $64.5 |
| Year ended December 31, 2003 | | | | | | |
| Reserves for doubtful accounts | $10.4 | $ 3.9 | $ — | $(3.9) (A) | $ — | $10.4 |
| Accrued liabilities for environmental matters | $52.3 | $ 4.1 | $3.1 | $(4.8) (B) | $ — | $54.7 |

Notes:
(A) Accounts written off.
(B) Cash payments during the year.
(C) Translation adjustments.

**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None.

**ITEM 9A. CONTROLS AND PROCEDURES**

**Disclosure controls and procedures**

PolyOne's management, with the participation of the Chief Executive Officer and the 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 December 31, 2005 and, based on this evaluation, has concluded that such disclosure controls and procedures are effective.

**Management's annual report on internal control over financial reporting**

The following report is provided by management in respect of PolyOne's internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934):

1. PolyOne's management is responsible for establishing and maintaining adequate internal control over financial reporting.

2. PolyOne's management has used the Committee of Sponsoring Organizations of the Treadway Commission (COSO) framework to evaluate the effectiveness of internal control over financial reporting. Management believes that the COSO framework is a suitable framework for its evaluation of financial reporting because it is free from bias, permits reasonably consistent qualitative and quantitative measurements of PolyOne's internal controls, is sufficiently complete so that those relevant factors that would alter a conclusion about the effectiveness of PolyOne's internal controls are not omitted and is relevant to an evaluation of internal control over financial reporting.

3. Management has assessed the effectiveness of PolyOne's internal control over financial reporting as of December 31, 2005 and has concluded that such internal control over financial reporting is effective. There were no material weaknesses in internal control over financial reporting identified by management.

4. Ernst & Young LLP, who audited the consolidated financial statements of PolyOne for the year ended December 31, 2005, also issued an attestation report on management's assessment of PolyOne's internal control over financial reporting under Auditing Standard No. 2 of the Public Company Accounting Oversight Board. This attestation report is set forth on page 32 of this Annual Report on Form 10-K and incorporated by reference into this Item 9A.

**Changes in internal control over financial reporting**

There were no changes in PolyOne's internal control over financial reporting during the quarter ended December 31, 2005 that have materially affected, or are reasonably likely to materially affect, its internal control over financial reporting.

## ITEM 9B. OTHER INFORMATION

None.

# PART III

## ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

The information regarding PolyOne's directors, including the identification of the audit committee and the audit committee financial expert, is incorporated by reference to the information contained in PolyOne's Proxy Statement to be filed on or about March 31, 2006 with respect to the 2006 Annual Meeting of Shareholders (2006 Proxy Statement). Information concerning executive officers is contained in Part I of this Annual Report under the heading "Executive Officers of the Company."

Information regarding Section 16(a) beneficial ownership reporting compliance is incorporated by reference to the material under the heading "Section 16(a) Beneficial Ownership Reporting Compliance" in PolyOne's 2006 Proxy Statement.

PolyOne has adopted a code of ethics that applies to its principal executive officer, principal financial officer and principal accounting officer. PolyOne's code of ethics is posted under the Investor Relations tab of its website at www.polyone.com. PolyOne will post any amendments to, or waivers of, its code of ethics that apply to its principal executive officer, principal financial officer and principal accounting officer on its website.

## ITEM 11. EXECUTIVE COMPENSATION

The information regarding executive compensation is incorporated by reference to the information contained in PolyOne's 2006 Proxy Statement.

## ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED SHAREHOLDER MATTERS

The information regarding security ownership of certain beneficial owners and management and securities authorized for issuance under PolyOne's equity compensation plans is incorporated by reference to the information contained in PolyOne's 2006 Proxy Statement.

## ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information regarding certain relationships and related transactions is incorporated by reference to the information contained in PolyOne's 2006 Proxy Statement.

## ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Information regarding fees paid to and services provided by PolyOne's independent registered public accounting firm during the fiscal years ended December 31, 2005 and 2004 and the pre-approval policies and procedures of the Audit Committee of PolyOne's Board of Directors is incorporated by reference to the information contained in PolyOne's 2006 Proxy Statement.

# PART IV

## ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a)(1) Financial Statements:

The following consolidated financial statements of PolyOne Corporation are included in Item 8:

Consolidated Statements of Operations for the years ended December 31, 2005, 2004 and 2003

Consolidated Balance Sheets at December 31, 2005 and 2004

Consolidated Statements of Cash Flows for the years ended December 31, 2005, 2004 and 2003

Consolidated Statements of Shareholders' Equity for the years ended December 31, 2005, 2004 and 2003

Notes to Consolidated Financial Statements

(a)(2) Financial Statement Schedules:

The following financial statements of subsidiaries not consolidated and 50% or less owned entities, as required by Item 15(c), are incorporated by reference to Exhibits 99.1 and 99.2 to this Form 10-K:

Consolidated financial statements of Oxy Vinyls, LP as of December 31, 2005 and for each of the three years then ended.

Consolidated financial statements of SunBelt Chlor Alkali Partnership as of December 31, 2005 and for each of the three years then ended.

The following consolidated financial statement schedule of PolyOne Corporation is included in Item 8:

Schedule II — Valuation and Qualifying Accounts

All other schedules for which provision is made in the applicable accounting regulation of the SEC are not required under the related instructions or are inapplicable and, therefore, omitted.

(a)(3) Exhibits.

| Exhibit | | Description |
|---|---|---|
| 3.1 | (k) | Articles of Incorporation |
| 3.1a | (b) | Amendment to the second article of the Articles of Incorporation, as filed with the Ohio Secretary of State November 25, 2003 |
| 3.2 | (k) | Regulations |
| 4.1 | (f) | Indenture dated as of December 1, 1995 between the Company and NBD Bank, Trustee |
| 4.2 | (d) | Form of Indenture between the Company and NBD Bank, as trustee, governing the Company's Medium Term Notes |
| 4.3 | (m) | Indenture, dated April 23, 2002, between the Company and The Bank of New York, as Trustee, including the form of the Company's 8.875% Senior Notes due May 2012 |
| 4.4 | (n) | Indenture, dated May 6, 2003, between the Company, as Issuer, and The Bank of New York, as trustee, including the form of the Company's 10 5/8% Senior Notes due May 15, 2010 |
| 10.1 | (a)+ | Long-Term Incentive Plan, as amended and restated |
| 10.1a | (c)+ | Form of Award Agreement for Performance Shares |
| 10.1b | (c)+ | Form of Award of Stock Appreciation Rights |
| 10.2 | (k)+ | Incentive Stock Plan, as amended and restated through August 31, 2000 |
| 10.3 | (k)+ | 1995 Incentive Stock Plan, as amended and restated through August 31, 2000 |
| 10.4 | (k)+ | 1998 Interim Stock Award Incentive Plan, as amended and restated through August 31, 2000 |
| 10.5 | (k)+ | 1999 Incentive Stock Plan, as amended and restated through August 31, 2000 |
| 10.6 | (j)+ | 2000 Stock Incentive Plan |
| 10.7 | (b)+ | Amendment No. 1 to the Amendment and Restatement of Supplemental Retirement Benefit Plan, effective as of May 31, 2003 |
| 10.8 | (k)+ | Benefit Restoration Plan (Section 401(a)(17)) |
| 10.8a | (b)+ | Third Amendment to Benefit Restoration Plan (Section 401(a)(17)), effective as of May 31, 2003 |
| 10.8b | (r)+ | Fourth Amendment to Benefits Restoration Plan, effective January 1, 2005 |
| 10.9a | (k)+ | Senior Executive Annual Incentive Plan (amended as of February 28, 2001 by Exhibit A [Definition of Change of Control] to Exhibit 10.9b below) |
| 10.9b | (p)+ | Strategic Improvement Incentive Plan Overview and Form of Award |
| 10.9c | (s)+ | Senior Executive Annual Incentive Plan, effective January 1, 2006 |
| 10.9d | (x)+ | 2005 Equity and Performance Incentive Plan (amended and restated by the Board as of July 21, 2005) |
| 10.10a | (b)+ | Non-Employee Directors Deferred Compensation Plan effective December 9, 1993, as amended and restated as of February 26, 2004 |
| 10.10b | (r)+ | Amendment to Non-Employee Directors Deferred Compensation Plan effective January 1, 2005 |
| 10.11a | (k)+ | Form of Management Continuity Agreement |
| 10.11b | *+ | Schedule of Executives with Management Continuity Agreements |
| 10.11c | (b)+ | Supplemental Retirement Benefit Plan, effective as of January 1, 2004 |
| 10.11d | (r)+ | Amendment to Supplemental Retirement Benefit Plan, effective January 1, 2005 |
| 10.11e | (t)+ | Separation Agreement Term Sheet between the Company and Thomas A. Waltermire, dated October 6, 2005 |
| 10.11f | (u)+ | Agreement between the Company and William F. Patient, effective October 6, 2005 |
| 10.11g | (w)+ | Separation Agreement between the Company and Thomas A. Waltermire dated December 21, 2005 |
| 10.11h | (y)+ | Letter Agreement by and between the Company and Stephen D. Newlin effective as of February 13, 2006 |
| 10.12a | (l) | $50 million Five Year Credit Agreement dated October 30, 2000, among the Company, Citicorp USA, Inc. and the other banks signatory thereto, as amended and restated as of May 6, 2003 |
| 10.12b | (o) | Amendment No. 2, dated as of September 25, 2003, to the foregoing $50 million Five Year Credit Agreement, as amended and restated as of May 6, 2003 |
| 10.12c | (q) | Amendment No. 3 and Waiver, dated as of August 5, 2004, to the foregoing Amended and Restated Credit Agreement, reducing the aggregate commitment to $30 million |
| 10.12d | (v) | Amendment No. 4, dated as of July 26, 2005, to the Amended and Restated Credit Agreement among the Company, as borrower, and Citicorp USA, Inc. as administrative agent for the lender parties thereto |

Table of Contents

| Exhibit | | Description |
|---|---|---|
| 10.12e | (l) | U.S. $225 million Trade Receivables Purchase Agreement, dated as of May 6, 2003, among PolyOne Funding Corporation, as the Seller, the Company, as the Servicer, the Banks and other Financial Institutions party thereto, as Purchasers, Citicorp USA, Inc., as the Agent, and National City Commercial Finance, Inc., as the Syndication Agent |
| 10.12f | (o) | Amendment No. 1, dated as of September 25, 2003, to the foregoing Trade Receivables Purchase Agreement, dated as of May 6, 2003 |
| 10.12g | (q) | Amendment No. 2, dated as of August 5, 2004, to the foregoing Trade Receivables Purchase Agreement, reducing to $175 million the amount of eligible receivables available to be sold |
| 10.12h | (v) | Amended and Restated Receivables Purchase Agreement dated as of July 26, 2005, among PolyOne Funding Corporation, as seller, the Company, as servicer, Citicorp USA, Inc., as agent for the purchaser parties thereto, and National City Business Credit, Inc., as syndication agent |
| 10.13 | (f) | Amended and Restated Instrument Guaranty dated as of December 19, 1996 |
| 10.14 | (f) | Amended and Restated Plant Services Agreement between the Company and The B.F. Goodrich Company |
| 10.15 | (f) | Amended and Restated Assumption of Liabilities and Indemnification Agreement dated March 1, 1993 and amended and restated April 27, 1993 |
| 10.16a | (e) | Partnership Agreement, by and between 1997 Chloralkali Venture Inc. and Olin Sunbelt, Inc. |
| 10.16b | (g) | Amendment to aforesaid Partnership Agreement (Addition of Section 5.03 of Article 5) |
| 10.16c | (g) | Amendment to aforesaid Partnership Agreement (Addition of Section 1.12) |
| 10.17 | (e) | Chlorine Sales Agreement, by and between Sunbelt Chlor Alkali Partnership and the Company |
| 10.18 | (e) | Intercompany Guarantee Agreement between the Company on the one hand and Olin Corporation and Sunbelt Chlor Alkali Partnership on the other hand |
| 10.19 | (g) | Guarantee by the Company of the Series G Sunbelt Chlor Alkali Partnership Guaranteed Secured Senior Notes Due 2017, dated December 22, 1997 |
| 10.20 | (h) | Master Transaction Agreement dated December 22, 1998 between The Geon Company and Occidental Chemical Corporation |
| 10.21 | (i) | Limited Partnership Agreement of Oxy Vinyls, LP |
| 10.22 | (i) | Asset Contribution Agreement — PVC Partnership (Geon) |
| 10.23 | (i) | Parent Agreement (Oxy Vinyls, LP) |
| 10.24 | (i) | Parent Agreement (PVC Powder Blends, LP) and Business Opportunity Agreement |
| 10.25 | * | Stock Purchase Agreement among O’Sullivan Films Holding Corporation, O’Sullivan Management, LLC, and Matrix Films, LLC, dated as of February 15, 2006 |
| 21.1 | * | Subsidiaries of the Company |
| 23.1 | * | Consent of Independent Registered Public Accounting Firm — Ernst & Young LLP |
| 23.2 | * | Consent of Independent Registered Public Accounting Firm — KPMG LLP |
| 23.3 | * | Consent of Independent Registered Public Accounting Firm — Ernst & Young LLP |
| 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 W. David Wilson, 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 pursuant to 18 U.S.C. § 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, as signed by Stephen D. Newlin, Chairman, President and Chief Executive Officer |
| 32.2 | * | Certification pursuant to 18 U.S.C. § 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, as signed by W. David Wilson, Vice President and Chief Financial Officer |
| 99.1 | * | Audited Financial Statements of Oxy Vinyls, LP |
| 99.2 | * | Audited Financial Statements of SunBelt Chlor Alkali Partnership |

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

* Filed herewith

(a) Incorporated by reference to the corresponding Exhibit filed with M.A. Hanna Company’s definitive proxy statement dated March 23, 2000, SEC File No. 1-05222.

(b) Incorporated by reference to the corresponding Exhibit filed with the Company’s Form 10-K for the year ended December 31, 2004, SEC File No. 1-16091.

| | |
|---|---|
| (c) | Incorporated by reference to the corresponding Exhibit filed with the Company's Form 8-K dated January 11, 2005, SEC File No. 1-16091. |
| (d) | Incorporated by reference to the corresponding Exhibit filed with M.A. Hanna Company's Form S-3 Registration Statement No. 333-05763, dated June 12, 1996. |
| (e) | Incorporated by reference to the corresponding Exhibit filed with The Geon Company's Form 10-Q for the Quarter ended September 30, 1996, SEC File No. 1-11804. |
| (f) | Incorporated by reference to the corresponding Exhibit filed with The Geon Company's Form 10-K for the Year ended December 31, 1996, SEC File No. 1-11804. |
| (g) | Incorporated by reference to the corresponding Exhibit filed with The Geon Company's Form 10-K for the Year ended December 31, 1997, SEC File No. 1-11804. |
| (h) | Incorporated by reference to the corresponding Exhibit filed with The Geon Company's Special Meeting Proxy Statement dated March 30, 1999, SEC File No. 1-11804. |
| (i) | Incorporated by reference to the corresponding Exhibit filed with The Geon Company's Form 8-K filed on May 13, 1999, SEC File No. 1-11804. |
| (j) | Incorporated by reference to the corresponding Exhibit filed with Amendment No. 3 to The Geon Company's Form S-4 Registration Statement No. 333-37344, dated July 28, 2000. |
| (k) | Incorporated by reference to the corresponding Exhibit filed with the Company's Form 10-K for the Year ended December 31, 2000, SEC File No. 1-16091. |
| (l) | Incorporated by reference to the corresponding Exhibit filed with the Company's Form 10-Q for the Quarter ended March 31, 2003, SEC File No. 1-16091. |
| (m) | Incorporated by reference to the corresponding Exhibit filed with the Company's Form S-4 Registration Statement No. 333-87472, dated May 2, 2002. |
| (n) | Incorporated by reference to the corresponding Exhibit filed with the Company's Form S-4 Registration Statement No. 333-105125, dated May 9, 2003. |
| (o) | Incorporated by reference to the corresponding Exhibit filed with the Company's Form 10-Q for the Quarter ended September 30, 2003, SEC File No. 1-16091 |
| (p) | Incorporated by reference to the corresponding Exhibit filed with the Company's Form 10-K for the Year ended December 31, 2001, SEC File No. 1-16091 |
| (q) | Incorporated by reference to the corresponding Exhibit filed with the Company's Form 10-Q for the quarter ended September 30, 2004, SEC File No. 1-16091 |
| (r) | Incorporated by reference to the corresponding Exhibit filed with the Company's Form 10-K for the year ended December 31, 2004, SEC File No. 1-16091 |
| (s) | Incorporated by reference to the Company's corresponding Exhibit filed with the Form 8-K dated May 24, 2005 SEC File No. 1-16091 |
| (t) | Incorporated by reference to the corresponding Exhibit filed with the Company's Form 8-K dated October 11, 2005, SEC File No. 1-16091 |
| (u) | Incorporated by reference to the corresponding Exhibit filed with the Company's Form 8-K filed on October 14, 2005, SEC File No. 1-16091 |
| (v) | Incorporated by reference to the corresponding Exhibit filed with the Company's Form 10-Q for the quarter ended September 30, 2005, SEC File No. 1-16091 |
| (w) | Incorporated by reference to the corresponding Exhibit filed with the Company's Form 8-K on December 21, 2005, SEC File No. 1-16091 |
| (x) | Incorporated by reference to the corresponding Exhibit filed with the Company's Form 10-Q for the quarter ended June 30, 2005, File No. 1-16091 |
| (y) | Incorporated by reference to the corresponding Exhibit filed with the Company's Form 8-K on February 17, 2006, SEC File No. 1-16091 |

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on March 15, 2006.

**POLYONE CORPORATION**

By: /s/ W. David Wilson
W. David Wilson
Vice President and Chief Financial Officer
(Authorized Officer and Principal Financial Officer)

By: /s/ Michael J. Meier
Michael J. Meier
Corporate Controller and Assistant Treasurer
(Authorized Officer and Principal Accounting Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated, as of March 15, 2006.

| Signature | Title |
|---|---|
| /s/ Stephen D. Newlin<br>Stephen D. Newlin | Chairman, President, Chief Executive Officer and Director<br>(Principal Executive Officer) |
| /s/ W. David Wilson<br>W. David Wilson | Vice President and Chief Financial Officer<br>(Authorized Officer and Principal Financial Officer) |
| /s/ Michael J. Meier<br>Michael J. Meier | Corporate Controller and Assistant Treasurer<br>(Authorized Officer and Principal Accounting Officer) |
| /s/ J. Douglas Campbell<br>J. Douglas Campbell | Director |
| /s/ Carol A. Cartwright<br>Carol A. Cartwright | Director |
| /s/ Gale Duff-Bloom<br>Gale Duff-Bloom | Director |
| /s/ Wayne R. Embry<br>Wayne R. Embry | Director |
| /s/ Richard H. Fearon<br>Richard H. Fearon | Director |
| /s/ Robert A. Garda<br>Robert A. Garda | Director |
| /s/ Gordon D. Harnett<br>Gordon D. Harnett | Director |
| /s/ William F. Patient<br>William F. Patient | Director |
| /s/ Farah M. Walters<br>Farah M. Walters | Director |

**EXHIBIT INDEX**

| Exhibit | | Description |
|---|---|---|
| 3.1 | (k) | Articles of Incorporation |
| 3.1a | (b) | Amendment to the second article of the Articles of Incorporation, as filed with the Ohio Secretary of State November 25, 2003 |
| 3.2 | (k) | Regulations |
| 4.1 | (f) | Indenture dated as of December 1, 1995 between the Company and NBD Bank, Trustee |
| 4.2 | (d) | Form of Indenture between the Company and NBD Bank, as trustee, governing the Company's Medium Term Notes |
| 4.3 | (m) | Indenture, dated April 23, 2002, between the Company and The Bank of New York, as Trustee, including the form of the Company's 8.875% Senior Notes due May 2012 |
| 4.4 | (n) | Indenture, dated May 6, 2003, between the Company, as Issuer, and The Bank of New York, as trustee, including the form of the Company's 10 $^{5}/_{8}$% Senior Notes due May 15, 2010 |
| 10.1 | (a)+ | Long-Term Incentive Plan, as amended and restated |
| 10.1a | (c)+ | Form of Award Agreement for Performance Shares |
| 10.1b | (c)+ | Form of Award of Stock Appreciation Rights |
| 10.2 | (k)+ | Incentive Stock Plan, as amended and restated through August 31, 2000 |
| 10.3 | (k)+ | 1995 Incentive Stock Plan, as amended and restated through August 31, 2000 |
| 10.4 | (k)+ | 1998 Interim Stock Award Incentive Plan, as amended and restated through August 31, 2000 |
| 10.5 | (k)+ | 1999 Incentive Stock Plan, as amended and restated through August 31, 2000 |
| 10.6 | (j)+ | 2000 Stock Incentive Plan |
| 10.7 | (b)+ | Amendment No. 1 to the Amendment and Restatement of Supplemental Retirement Benefit Plan, effective as of May 31, 2003 |
| 10.8 | (k)+ | Benefit Restoration Plan (Section 401(a)(17)) |
| 10.8a | (b)+ | Third Amendment to Benefit Restoration Plan (Section 401(a)(17)), effective as of May 31, 2003 |
| 10.8b | (r)+ | Fourth Amendment to Benefits Restoration Plan, effective January 1, 2005 |
| 10.9a | (k)+ | Senior Executive Annual Incentive Plan (amended as of February 28, 2001 by Exhibit A [Definition of Change of Control] to Exhibit 10.9b below) |
| 10.9b | (p)+ | Strategic Improvement Incentive Plan Overview and Form of Award |
| 10.9c | (s)+ | Senior Executive Annual Incentive Plan, effective January 1, 2006 |
| 10.9d | (x)+ | 2005 Equity and Performance Incentive Plan (amended and restated by the Board as of July 21, 2005) |
| 10.10a | (b)+ | Non-Employee Directors Deferred Compensation Plan effective December 9, 1993, as amended and restated as of February 26, 2004 |
| 10.10b | (r)+ | Amendment to Non-Employee Directors Deferred Compensation Plan effective January 1, 2005 |
| 10.11a | (k)+ | Form of Management Continuity Agreement |
| 10.11b | *+ | Schedule of Executives with Management Continuity Agreements |
| 10.11c | (b)+ | Supplemental Retirement Benefit Plan, effective as of January 1, 2004 |
| 10.11d | (r)+ | Amendment to Supplemental Retirement Benefit Plan, effective January 1, 2005 |
| 10.11e | (t)+ | Separation Agreement Term Sheet between the Company and Thomas A. Waltermire, dated October 6, 2005 |
| 10.11f | (u)+ | Agreement between the Company and William F. Patient, effective October 6, 2005 |
| 10.11g | (w)+ | Separation Agreement between the Company and Thomas A. Waltermire dated December 21, 2005 |
| 10.11h | (y)+ | Letter Agreement by and between the Company and Stephen D. Newlin effective as of February 13, 2006 |
| 10.12a | (l) | $50 million Five Year Credit Agreement dated October 30, 2000, among the Company, Citicorp USA, Inc. and the other banks signatory thereto, as amended and restated as of May 6, 2003 |

Table of Contents

| Exhibit | | Description |
|---|---|---|
| 10.12b | (o) | Amendment No. 2, dated as of September 25, 2003, to the foregoing $50 million Five Year Credit Agreement, as amended and restated as of May 6, 2003 |
| 10.12c | (q) | Amendment No. 3 and Waiver, dated as of August 5, 2004, to the foregoing Amended and Restated Credit Agreement, reducing the aggregate commitment to $30 million |
| 10.12d | (v) | Amendment No. 4, dated as of July 26, 2005, to the Amended and Restated Credit Agreement among the Company, as borrower, and Citicorp USA, Inc. as administrative agent for the lender parties thereto |
| 10.12e | (l) | U.S. $225 million Trade Receivables Purchase Agreement, dated as of May 6, 2003, among PolyOne Funding Corporation, as the Seller, the Company, as the Servicer, the Banks and other Financial Institutions party thereto, as Purchasers, Citicorp USA, Inc., as the Agent, and National City Commercial Finance, Inc., as the Syndication Agent |
| 10.12f | (o) | Amendment No. 1, dated as of September 25, 2003, to the foregoing Trade Receivables Purchase Agreement, dated as of May 6, 2003 |
| 10.12g | (q) | Amendment No. 2, dated as of August 5, 2004, to the foregoing Trade Receivables Purchase Agreement, reducing to $175 million the amount of eligible receivables available to be sold |
| 10.12h | (v) | Amended and Restated Receivables Purchase Agreement dated as of July 26, 2005, among PolyOne Funding Corporation, as seller, the Company, as servicer, Citicorp USA, Inc., as agent for the purchaser parties thereto, and National City Business Credit, Inc., as syndication agent |
| 10.13 | (f) | Amended and Restated Instrument Guaranty dated as of December 19, 1996 |
| 10.14 | (f) | Amended and Restated Plant Services Agreement between the Company and The B.F. Goodrich Company |
| 10.15 | (f) | Amended and Restated Assumption of Liabilities and Indemnification Agreement dated March 1, 1993 and amended and restated April 27, 1993 |
| 10.16a | (e) | Partnership Agreement, by and between 1997 Chloralkali Venture Inc. and Olin Sunbelt, Inc. |
| 10.16b | (g) | Amendment to aforesaid Partnership Agreement (Addition of Section 5.03 of Article 5) |
| 10.16c | (g) | Amendment to aforesaid Partnership Agreement (Addition of Section 1.12) |
| 10.17 | (e) | Chlorine Sales Agreement, by and between Sunbelt Chlor Alkali Partnership and the Company |
| 10.18 | (e) | Intercompany Guarantee Agreement between the Company on the one hand and Olin Corporation and Sunbelt Chlor Alkali Partnership on the other hand |
| 10.19 | (g) | Guarantee by the Company of the Series G Sunbelt Chlor Alkali Partnership Guaranteed Secured Senior Notes Due 2017, dated December 22, 1997 |
| 10.20 | (h) | Master Transaction Agreement dated December 22, 1998 between The Geon Company and Occidental Chemical Corporation |
| 10.21 | (i) | Limited Partnership Agreement of Oxy Vinyls, LP |
| 10.22 | (i) | Asset Contribution Agreement — PVC Partnership (Geon) |
| 10.23 | (i) | Parent Agreement (Oxy Vinyls, LP) |
| 10.24 | (i) | Parent Agreement (PVC Powder Blends, LP) and Business Opportunity Agreement |
| 10.25 | * | Stock Purchase Agreement among O’Sullivan Films Holding Corporation, O’Sullivan Management, LLC, and Matrix Films, LLC, dated as of February 15, 2006 |
| 21.1 | * | Subsidiaries of the Company |
| 23.1 | * | Consent of Independent Registered Public Accounting Firm — Ernst & Young LLP |
| 23.2 | * | Consent of Independent Registered Public Accounting Firm — KPMG LLP |
| 23.3 | * | Consent of Independent Registered Public Accounting Firm — Ernst & Young LLP |
| 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 W. David Wilson, 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 pursuant to 18 U.S.C. § 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, as signed by Stephen D. Newlin, Chairman, President and Chief Executive Officer |

| Exhibit | | Description |
|---|---|---|
| 32.2 | * | Certification pursuant to 18 U.S.C. § 1350, adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, as signed by W. David Wilson, Vice President and Chief Financial Officer |
| 99.1 | * | Audited Financial Statements of Oxy Vinyls, LP |
| 99.2 | * | Audited Financial Statements of SunBelt Chlor Alkali Partnership |

| | |
|---|---|
| + | Indicates management contract or compensatory plan, contract or arrangement in which one or more directors or executive officers of the Registrant may be participants |
| * | Filed herewith |
| (a) | Incorporated by reference to the corresponding Exhibit filed with M.A. Hanna Company's definitive proxy statement dated March 23, 2000, SEC File No. 1-05222. |
| (b) | Incorporated by reference to the corresponding Exhibit filed with the Company's Form 10-K for the year ended December 31, 2004, SEC File No. 1-16091. |
| (c) | Incorporated by reference to the corresponding Exhibit filed with the Company's Form 8-K dated January 11, 2005, SEC File No. 1-16091. |
| (d) | Incorporated by reference to the corresponding Exhibit filed with M.A. Hanna Company's Form S-3 Registration Statement No. 333-05763, dated June 12, 1996. |
| (e) | Incorporated by reference to the corresponding Exhibit filed with The Geon Company's Form 10-Q for the Quarter ended September 30, 1996, SEC File No. 1-11804. |
| (f) | Incorporated by reference to the corresponding Exhibit filed with The Geon Company's Form 10-K for the Year ended December 31, 1996, SEC File No. 1-11804. |
| (g) | Incorporated by reference to the corresponding Exhibit filed with The Geon Company's Form 10-K for the Year ended December 31, 1997, SEC File No. 1-11804. |
| (h) | Incorporated by reference to the corresponding Exhibit filed with The Geon Company's Special Meeting Proxy Statement dated March 30, 1999, SEC File No. 1-11804. |
| (i) | Incorporated by reference to the corresponding Exhibit filed with The Geon Company's Form 8-K filed on May 13, 1999, SEC File No. 1-11804. |
| (j) | Incorporated by reference to the corresponding Exhibit filed with Amendment No. 3 to The Geon Company's Form S-4 Registration Statement No. 333-37344, dated July 28, 2000. |
| (k) | Incorporated by reference to the corresponding Exhibit filed with the Company's Form 10-K for the Year ended December 31, 2000, SEC File No. 1-16091. |
| (l) | Incorporated by reference to the corresponding Exhibit filed with the Company's Form 10-Q for the Quarter ended March 31, 2003, SEC File No. 1-16091. |
| (m) | Incorporated by reference to the corresponding Exhibit filed with the Company's Form S-4 Registration Statement No. 333-87472, dated May 2, 2002. |
| (n) | Incorporated by reference to the corresponding Exhibit filed with the Company's Form S-4 Registration Statement No. 333-105125, dated May 9, 2003. |
| (o) | Incorporated by reference to the corresponding Exhibit filed with the Company's Form 10-Q for the Quarter ended September 30, 2003, SEC File No. 1-16091 |
| (p) | Incorporated by reference to the corresponding Exhibit filed with the Company's Form 10-K for the Year ended December 31, 2001, SEC File No. 1-16091 |
| (q) | Incorporated by reference to the corresponding Exhibit filed with the Company's Form 10-Q for the quarter ended September 30, 2004, SEC File No. 1-16091 |
| (r) | Incorporated by reference to the corresponding Exhibit filed with the Company's Form 10-K for the year ended December 31, 2004, SEC File No. 1-16091 |
| (s) | Incorporated by reference to the Company's corresponding Exhibit filed with the Form 8-K dated May 24, 2005 SEC File No. 1-16091 |
| (t) | Incorporated by reference to the corresponding Exhibit filed with the Company's Form 8-K dated October 11, 2005, SEC File No. 1-16091 |
| (u) | Incorporated by reference to the corresponding Exhibit filed with the Company's Form 8-K filed on October 14, 2005, SEC File No. 1-16091 |
| (v) | Incorporated by reference to the corresponding Exhibit filed with the Company's Form 10-Q for the quarter ended September 30, 2005, SEC File No. 1-16091 |
| (w) | Incorporated by reference to the corresponding Exhibit filed with the Company's Form 8-K on December 21, 2005, SEC File No. 1-16091 |
| (x) | Incorporated by reference to the corresponding Exhibit filed with the Company's Form 10-Q for the quarter ended June 30, 2005, File No. 1-16091 |
| (y) | Incorporated by reference to the corresponding Exhibit filed with the Company's Form 8-K on February 17, 2006, SEC File No. 1-16091 |

.
.
.

EXHIBIT 10.11(b)

SCHEDULE OF EXECUTIVES WITH
CONTINUITY AGREEMENTS

| TITLE | NAME | YEARS/COMP* |
|---|---|---|
| Chairman, President and Chief Executive Officer......... | Stephen D. Newlin | 3 |
| Vice President and General Manager, Distribution........ | Michael L. Rademacher | 3 |
| Vice President, Chief Legal Officer and Secretary....... | Wendy C. Shiba | 3 |
| Vice President and Chief Information and Human Resources Officer............................................. | Kenneth M. Smith | 3 |
| Vice President and Chief Financial Officer............. | W. David Wilson | 3 |
| Vice President and General Manager, International Compounds and Colors................................ | Bernard Baert | 2 |
| Vice President and General Manager, Producer Services... | Patrick F. Burke | 1 |
| Vice President and General Manager, Engineered Materials........................................... | Richard J. Burns | 1 |
| Vice President and General Manager, North American Vinyl Compounds........................................... | Robert M. Rosenau | 3 |
| Vice President and Chief Technology Officer............ | Roger W. Avakian | 1 |
| Vice President and Chief Investor and Communications Officer............................................. | Dennis A. Cocco | 1 |
| Vice President , Polymer Coating Systems............... | Daniel L. Kickel | 1 |
| Treasurer............................................. | John L. Rastetter | 1 |
| Controller and Assistant Treasurer..................... | Michael J. Meier | 1 |
| Vice President and General Manager, Specialty Resins.... | Francois S. Cote | 1 |

- ---------------

* Years of compensation payable upon change of control.

Exhibit 10.25

EXECUTION VERSION

# STOCK PURCHASE AGREEMENT

BY AND AMONG

O'SULLIVAN FILMS HOLDING CORPORATION,

O'SULLIVAN FILMS MANAGEMENT, LLC,

AND

MATRIX FILMS, LLC

DATED AS OF

FEBRUARY 15, 2006

TABLE OF CONTENTS


| | PAGE |
|---|---|
| ARTICLE I DEFINITIONS | 2 |
| 1.1 Certain Defined Terms | 2 |
| 1.2 Other Interpretive Provisions | 5 |
| ARTICLE II PURCHASE AND SALE | 6 |
| 2.1 Subscription for the Shares | 6 |
| 2.2 Use of Proceeds | 6 |
| ARTICLE III DELIVERIES AND OTHER ACTIONS | 6 |
| 3.1 Deliveries by the Seller | 6 |
| 3.2 Deliveries by the Buyers | 7 |
| ARTICLE IV REPRESENTATIONS AND WARRANTIES OF THE SELLER | 8 |
| 4.1 Organization | 8 |
| 4.2 Authorization; Enforceability | 8 |
| 4.3 Capital Stock of the Seller | 8 |
| 4.4 Capital Stock of the Company | 9 |
| 4.5 Subsidiaries | 9 |
| 4.6 No Conflicts or Approvals | 10 |
| 4.7 Proceedings | 10 |
| 4.8 No Brokers' or Other Fees | 10 |
| 4.9 No Other Representations or Warranties | 10 |
| ARTICLE V REPRESENTATIONS AND WARRANTIES OF THE BUYERS | 11 |
| 5.1 Organization | 11 |
| 5.2 Authorization; Enforceability | 11 |
| 5.3 No Approvals or Conflicts | 11 |
| 5.4 Proceedings | 12 |
| 5.5 No Brokers' or Other Fees | 12 |
| 5.6 Investment Intent | 12 |
| 5.7 Ability to Bear Risk; Sophistication; Inquiry | 12 |
| 5.8 Accredited Investor | 13 |
| 5.9 Financing | 13 |
| 5.10 No Reliance | 13 |
| 5.11 No Other Representations or Warranties | 13 |
| ARTICLE VI COVENANTS AND AGREEMENTS | 13 |
| 6.1 Transfer Taxes | 13 |
| 6.2 Confidentiality | 13 |

6.3 Injunctive Relief; Limitation on Scope .......................... 14

ARTICLE VII INDEMNIFICATION .............................................. 14
7.1 Indemnification by the Seller .................................. 14
7.2 Indemnification by the Buyers .................................. 14
7.3 Indemnification as Exclusive Remedy ............................ 14
7.4 Limitations on Indemnification ................................. 15
7.5 Procedures ..................................................... 15

ARTICLE VIII MISCELLANEOUS ............................................... 16
8.1 Fees and Expenses .............................................. 16
8.2 Governing Law .................................................. 16
8.3 Projections .................................................... 16
8.4 Amendment ...................................................... 17
8.5 Assignment ..................................................... 17
8.6 Waiver ......................................................... 17
8.7 Notices ........................................................ 17
8.8 Complete Agreement ............................................. 19
8.9 Counterparts ................................................... 19
8.10 Publicity ..................................................... 19
8.11 Headings ...................................................... 19
8.12 Severability .................................................. 19
8.13 Third Parties ................................................. 20
8.14 Further Assurances ............................................ 20
8.15 Arbitration ................................................... 20
8.16 Consent to Jurisdiction; Waiver of Jury Trial ................. 20

Schedules

| | |
|---|---|
| Schedule 1.1(a) | Knowledge of the Buyers |
| Schedule 4.1 | Organization |
| Schedule 4.3 | Capital Stock of the Seller |
| Schedule 4.4 | Capital Stock of the Company |
| Schedule 4.6(a) | No Conflicts (Seller) |
| Schedule 4.6(b) | Consents (Seller) |
| Schedule 4.7 | Proceedings (Seller) |
| Schedule 5.3(a) | No Conflicts (Buyer) |
| Schedule 5.3(b) | Consents (Buyer) |
| Schedule 5.4 | Proceedings (Buyer) |

Exhibits

| | |
|---|---|
| Exhibit A | Form of Promissory Note |
| Exhibit B | Form of Seller's Receipt |
| Exhibit C | Form of Stockholders' Agreement |
| Exhibit D | Form of Buyers' Receipt |

# STOCK PURCHASE AGREEMENT

This STOCK PURCHASE AGREEMENT, dated as of February 15, 2006, is by and among O'Sullivan Films Holding Corporation, a Delaware corporation (the "SELLER"), Matrix Films, LLC, a Virginia limited liability company (the "EQUITY INVESTOR"), and O'Sullivan Films Management, LLC, a Virginia limited liability company (the "MANAGEMENT INVESTOR" and, together with the Equity Investor, the "BUYERS").

A. All of the issued and outstanding shares of capital stock of the Seller are owned by PolyOne Corporation, an Ohio corporation ("POLYONE");

B. The Seller owns the issued and outstanding shares of capital stock of O'Sullivan Films, Inc., a Delaware corporation (the "COMPANY");

C. The Company is engaged in the business of developing and processing polymer film and sheeting products and producing polymer film and sheeting, in each case as conducted by the Company in the United States of America (the "EFG BUSINESS"); and

D. The Seller desires to sell to the Equity Investor, and the Equity Investor desires to purchase and acquire from the Seller, upon the terms and subject to the conditions set forth in this Agreement, 33 shares of the voting Common Stock, par value $0.01 per share, of the Seller (the "EQUITY VOTING SHARES"), and 187 shares of the non-voting Common Stock, par value $0.01 per share, of the Seller (the "EQUITY NON-VOTING SHARES" and, together with the Equity Voting Shares, the "EQUITY SHARES"), which Equity Shares will, immediately after the execution of this Agreement, evidence approximately 25% of the issued and outstanding capital stock of the Seller, all only to the extent further described below, in consideration of certain payments by the Equity Investor specifically described in this Agreement.

E. The Seller desires to sell to the Management Investor, and the Management Investor desires to purchase and acquire from the Seller, upon the terms and subject to the conditions set forth in this Agreement, 49 shares of the voting Common Stock, par value $0.01 per share, of the Seller (the "MANAGEMENT VOTING SHARES"), and 491 shares of the non-voting Common Stock, par value $0.01 per share, of the Seller (the "MANAGEMENT NON-VOTING SHARES" and, together with the Management Voting Shares, the "MANAGEMENT SHARES"), which Management Shares will, immediately after the execution of this Agreement, evidence approximately 57% of the issued and outstanding capital stock of the Seller, all only to the extent further described below, in consideration of certain payments by the Management Investor specifically described in this Agreement (the Management Shares together with the Equity Shares, the "SHARES").

NOW, THEREFORE, in consideration of the mutual promises and representations and upon the terms and subject to the conditions set forth in this Agreement, and other good and valuable consideration, had and received, the receipt and sufficiency of which are hereby acknowledged, the parties hereto hereby agree as follows:

ARTICLE I
DEFINITIONS

1.1 CERTAIN DEFINED TERMS. As used in this Agreement, the following terms have the following meanings:

"1933 ACT" means the Securities Act of 1933, as amended, and the rules and regulations promulgated thereunder.

"AAA" has the meaning set forth in SECTION 8.15.

"AFFILIATE" means, with respect to any specified Person, any other Person that directly or indirectly controls, is controlled by, or is under common control with, such specified Person. The terms "control," "controlled by" and "under common control with", with respect to the relationship between or among two or more Persons, means the possession, directly or indirectly, of the power to direct or cause the direction of the affairs or management of a Person, whether through the ownership of voting securities, by contract or otherwise, including the ownership, directly or indirectly, of securities having the power to elect a majority of the board of directors or similar body governing the affairs of such Person.

"AGREEMENT" means this Stock Purchase Agreement (including the Disclosure Schedules), as amended, modified or supplemented from time to time.

"ANCILLARY AGREEMENTS" means the Promissory Note, the Seller's Receipt, the Buyers' Receipt, the Stockholders' Agreement, and each other agreement, document, instrument or certificate contemplated by this Agreement or to be executed by the Buyers or the Seller in connection with the consummation of the transactions contemplated by this Agreement, in each case only as applicable to the relevant party or parties to such Ancillary Agreement, as indicated by the context in which such term is used.

"BUSINESS DAY" means any day that is not a Saturday, a Sunday or other day on which banks in New York, New York are required or authorized by Law to be closed.

"BUYERS" has the meaning set forth in the preamble.

"BUYER INDEMNIFIED PERSONS" has the meaning set forth in SECTION 7.1(A).

"BUYER MATERIAL ADVERSE EFFECT" means any change, occurrence or development that has a material adverse effect on the business, results of operations or financial condition of either of the Buyers and its subsidiaries, taken as a whole, but excludes any effect (a) resulting from general economic conditions (whether as a result of acts of terrorism, war (whether or not declared), armed conflicts or otherwise), (b) affecting companies in the industry in which it conducts its business generally, (c) resulting from the announcement or performance of this

Agreement or the transactions contemplated hereby or (d) resulting from any actions required under this Agreement to obtain any Consent from any Person.

"BUYERS' RECEIPT" has the meaning set forth in SECTION 3.2(B).

"CLAIM" has the meaning set forth in SECTION 7.5(A).

"CLAIM NOTICE" has the meaning set forth in SECTION 7.5(A).

"CLOSING" means the time at which the Buyers and the Seller consummate the sale of the Shares as provided in this Agreement by the execution and delivery by the Seller of the documents and instruments referred to in SECTION 3.1 against delivery by the Buyers of the documents, items and instruments referred to in SECTION 3.2.

"CLOSING DATE" means the date on which the Closing occurs.

"COMMON STOCK" has the meaning set forth in SECTION 4.3.

"COMPANY" has the meaning set forth in the recitals.

"COMPANY MATERIAL ADVERSE EFFECT" means any change, occurrence or development that has a material adverse effect on the business, results of operations or financial condition of the EFG Business, taken as a whole, but excludes any effect (a) resulting from general economic conditions (whether as a result of acts of terrorism, war (whether or not declared), armed conflict or otherwise), (b) impacting companies in the industry in which the EFG Business is conducted generally, (c) resulting from the announcement or performance of this Agreement or the transactions contemplated hereby or (d) resulting from any actions required under this Agreement to obtain any Consent from any Person.

"COMPANY STOCK" has the meaning set forth in SECTION 4.4.

"CONSENT" means any consent, approval, authorization, waiver or notification required to be obtained from, filed with or delivered to any Governmental Authority or other Person in connection with the consummation of the transactions contemplated hereby.

"DISCLOSURE SCHEDULES" means the schedules attached to this Agreement.

"EFG BUSINESS" has the meaning set forth in the recitals.

"EQUITY INVESTOR" has the meaning set forth in the preamble.

"EQUITY NON-VOTING SHARES" has the meaning set forth in the recitals.

"EQUITY SHARES" has the meaning set forth in the recitals.

"EQUITY VOTING SHARES" has the meaning set forth in the recitals.

"GENERAL ENFORCEABILITY EXCEPTIONS" has the meaning set forth in SECTION 4.2.

"GOVERNMENTAL AUTHORITY" means any government or other political subdivision (whether federal, state, local, feral or foreign), or any agency or instrumentality of any such government or political subdivision, or any federal, state, local, feral or foreign court or arbitrator, court sanctioned or agreed-upon.

"GOVERNMENTAL ORDER" has the meaning set forth in SECTION 4.6(A).

"INDEMNIFIED PARTY" means a party entitled to indemnification under this Agreement.

"INDEMNIFYING PARTY" means a party obligated to provide indemnification under this Agreement.

"KNOWLEDGE OF THE BUYERS" means the actual knowledge of the individuals listed on SCHEDULE 1.1(A).

"LAW" means any law, statute, code, ordinance, rule or regulation of any Governmental Authority.

"LECLAIR RYAN" has the meaning set forth in SECTION 2.2(C).

"LIEN" means any voting trust, shareholder agreement, proxy or other similar restriction, lien, mortgage, pledge, security interest, or other encumbrance.

"LOSSES" means any and all claims, liabilities, losses, damages, fines, penalties and costs (in each case including reasonable out-of-pocket expenses).

"MANAGEMENT INVESTOR" has the meaning set forth in the preamble.

"MANAGEMENT NON-VOTING SHARES" has the meaning set forth in the recitals.

"MANAGEMENT SHARES" has the meaning set forth in the recitals.

"MANAGEMENT VOTING SHARES" has the meaning set forth in the recitals.

"OUTSTANDING NON-VOTING COMMON STOCK" has the meaning set forth in SECTION 4.3.

"OUTSTANDING STOCK" has the meaning set forth in SECTION 4.3.

"OUTSTANDING VOTING COMMON STOCK" has the meaning set forth in SECTION 4.3.

"PERMITTED LIEN" means Liens for Taxes, assessments and other charges of Governmental Authorities not yet due and payable or being contested in good faith by appropriate proceedings.

"PERSON" means any individual, sole proprietorship, partnership, firm, corporation, association, trust, unincorporated organization, joint venture, limited liability company, Governmental Authority or other legal entity.

"POLYONE" has the meaning set forth in the recitals.

"PROCEEDING" means any action, suit, legal proceeding, administrative enforcement proceeding or arbitration proceeding before any Governmental Authority.

"PROMISSORY NOTE" has the meaning set forth in SECTION 2.1.

"PURCHASE PRICE" has the meaning set forth in SECTION 2.1.

"RESPONSIBLE PARTY" has the meaning set forth in SECTION 7.5(B)(II).

"SELLER" has the meaning set forth in the preamble.

"SELLER INDEMNIFIED PERSONS" has the meaning set forth in SECTION 7.2.

"SELLER'S RECEIPT" has the meaning set forth in SECTION 3.1(B).

"SHARES" has the meaning set forth in the recitals.

"STOCKHOLDERS' AGREEMENT" has the meaning set forth in SECTION 3.1(D).

"SUBSCRIPTION" has the meaning set forth in SECTION 2.1.

"TAX" or "TAXES" means any income, alternative or add-on minimum, gross receipts, sales, use, ad valorem, franchise, profits, license, transfer, withholding, payroll, employment, excise, severance, stamp, occupation, premium, value added, property, environmental or windfall profits taxes, customs, duties or similar fees, assessments or charges of any kind whatsoever, together with any interest and any penalties, additions to tax or additional amounts imposed by any Taxing Authority.

"TAXING AUTHORITY" means any Governmental Authority responsible for the administration or imposition of any Tax.

"THIRD PARTY CLAIM" has the meaning set forth in SECTION 7.5(B)(I).

"TRANSFER TAXES" has the meaning set forth in SECTION 6.1.

1.2 OTHER INTERPRETIVE PROVISIONS. The words "hereof," "herein" and "hereunder" and words of similar import when used in this Agreement refer to this Agreement as a whole (including any Disclosure Schedules hereto) and not to any particular provision of this Agreement, and all Article, Section, Schedule and Exhibit references are to this Agreement unless otherwise specified. The words "include," "includes" and "including" will be deemed to be followed by the phrase "without limitation." The meanings given to terms defined herein and

references herein will be equally applicable to both the singular and plural forms of such terms. Whenever the context may require, any pronoun includes the corresponding masculine, feminine and neuter forms. Except as otherwise expressly provided herein, all references to "dollars" or "$" will be deemed references to the lawful money of the United States of America.

## ARTICLE II
## PURCHASE AND SALE

2.1 SUBSCRIPTION FOR THE SHARES. Concurrently with the execution of this Agreement and subject to the terms and conditions set forth in this Agreement, the Buyers shall subscribe and apply for the purchase of the Shares (the "SUBSCRIPTION"), and the Buyers shall pay to the Seller, in exchange therefor, the aggregate sum of $1,515,000 (the "PURCHASE PRICE"), consisting of $550,000 in cash from the Equity Investor, $875,000 in cash from the Management Investor, and $90,000 of which will be paid in the form of a promissory note issued by the Management Investor to the Seller as payee in substantially the form attached hereto as EXHIBIT A (the "PROMISSORY NOTE"). The Buyers shall pay the Purchase Price to the Seller by wire transfers of immediately available funds to accounts designated in writing by Seller, which accounts will have been designated at least one Business Day prior to the date of this Agreement, and by delivery of the Promissory Note at Closing.

2.2 USE OF PROCEEDS. At Closing, the Seller shall pay out of the Purchase Price, by wire transfers of immediately available funds to accounts designated in writing (which accounts will have been designated at least one Business Day prior to the date of this Agreement) (a) $250,000 to Matrix Capital Markets Group, Inc. as a closing fee; (b) $50,000 to PolyOne as reimbursement for the prior payment by PolyOne of a retainer fee for Matrix Capital Markets Group, Inc.; (c) $205,577.93 to PolyOne as reimbursement for the prior payment by PolyOne of legal fees to LeClair Ryan, A Professional Corporation, which firm serves as counsel for the Buyers ("LECLAIR RYAN"), in excess of $50,000; (d) $105,000 to PolyOne as reimbursement for the prior payment by PolyOne to GMAC Commercial Finance, LLC of certain due diligence deposits; (e) $50,000 to PolyOne as reimbursement for the prior payment by PolyOne to LaSalle Business Credit, LLC of a deposit; (f) $22,337.50 to PolyOne as reimbursement for the prior payment by PolyOne to Chicago Title Insurance Co. of certain transfer taxes and recording fees; (g) $1,200 to PolyOne as reimbursement for the prior payment by PolyOne to Wachovia of environmental review completion expenses; and (h) $29,150 to PolyOne as reimbursement for the prior payment by PolyOne to Survey America Inc., or individual surveyors, for surveys of EFG Business real estate in both Winchester, Virginia and Lebanon, Pennsylvania.

## ARTICLE III
## DELIVERIES AND OTHER ACTIONS

3.1 DELIVERIES BY THE SELLER. Concurrently with the execution of this Agreement, the Seller shall deliver, or cause to be delivered, to each Buyer the following items:

(a) newly-issued stock certificate(s) representing the Shares purchased by such Buyer and issued in the name of such Buyer;

(b) a receipt, in substantially the form attached hereto as EXHIBIT B (the "SELLER'S RECEIPT"), evidencing the Seller's receipt of the Purchase Price;

(c) copies of the resolutions of the board of directors of the Seller authorizing and approving this Agreement, the Subscription, and all other transactions and agreements contemplated by this Agreement, certified by the Secretary or an Assistant Secretary of the Seller to be true and complete and in full force and effect and unmodified as of the date of this Agreement;

(d) a stockholders' agreement, in the form attached hereto as EXHIBIT C, by and among the Seller, the Buyers, and PolyOne (the "STOCKHOLDERS' AGREEMENT"), duly executed by the Seller and PolyOne;

(e) a copy of the certificate of incorporation of the Seller certified as of a date no more than 16 days prior to the date of this Agreement by the Secretary of State of the State of Delaware;

(f) a certificate of the Secretary of State of the State of Delaware as to the good standing of the Seller as of a date no more than 16 days prior to the Closing Date;

(g) a certificate of the Secretary or an Assistant Secretary of the Seller, given by him or her on behalf of the Seller and not in his or her individual capacity, certifying as to the bylaws of the Seller.

(h) a copy of the certificate of incorporation of the Company certified as of a date no more than 16 days prior to the date of this Agreement by the Secretary of State of the State of Delaware;

(i) a certificate of the Secretary of State of the State of Delaware as to the good standing of the Company as of a date no more than 16 days prior to the Closing Date; and

(j) a certificate of the Secretary or an Assistant Secretary of the Company, given by him or her on behalf of the Company and not in his or her individual capacity, certifying as to the bylaws of the Company.

3.2 DELIVERIES BY THE BUYERS. Concurrently with the execution of this Agreement, the Buyers shall deliver, or cause to be delivered, to the Seller the following items:

(a) the Purchase Price as provided in SECTION 2.1, including the Promissory Note, duly executed by the Management Investor.

(b) a receipt, in substantially the form attached hereto as EXHIBIT D (the "BUYERS' RECEIPT"), evidencing the Buyers' receipt of the Shares;

(c) a copy of the Stockholders' Agreement, duly executed by the Buyers;

(d) copies of the resolutions of the boards of managers or the members, as appropriate, of each Buyer authorizing and approving this Agreement, the Subscription, and all other transactions and agreements contemplated by this Agreement, certified by the Secretary or an Assistant Secretary of each Buyer to be true and complete and in full force and effect and unmodified as of the date of this Agreement;

(e) a copy of the articles of organization of the Buyers certified as of a date no more than 16 days prior to the date of this Agreement by the State Corporation Commission of the Commonwealth of Virginia;

(f) a certificate of existence issued by the State Corporation Commission of the Commonwealth of Virginia for each Buyer as of a date no more than 16 days prior to the Closing Date; and

(g) a certificate of the Secretary or an Assistant Secretary of each Buyer, given by him or her on behalf of such Buyer and not in his or her individual capacity, certifying as to the operating agreement of such Buyer.

## ARTICLE IV
## REPRESENTATIONS AND WARRANTIES OF THE SELLER

The Seller hereby represents and warrants to the Buyers as follows:

4.1 ORGANIZATION. Each of the Seller and the Company is a corporation duly incorporated, validly existing and in good standing under the Laws of the State of Delaware. The Seller has the requisite corporate power and authority to carry on the EFG Business as currently conducted. The Company has the requisite corporate power and authority to own, lease and operate its assets and to carry on its business as now being conducted and, except as indicated on SCHEDULE 4.1, is duly qualified or licensed to do business and is in good standing in the jurisdictions in which the ownership of its property or the conduct of its business requires such qualification or license, except where the failure to be so qualified or licensed (a) would not reasonably be expected, individually or in the aggregate, to have a material adverse effect on the ability of the Seller to consummate the transactions contemplated by this Agreement or (b) with respect to the Company, would not reasonably be expected, individually or in the aggregate, to have a Company Material Adverse Effect.

4.2 AUTHORIZATION; ENFORCEABILITY. The Seller has the requisite corporate power and authority to execute and deliver this Agreement and the Ancillary Agreements to which it is a party and to perform its obligations hereunder and thereunder. The execution and delivery of this Agreement and all applicable Ancillary Agreements by the Seller and the performance by it of its obligations hereunder and thereunder have been duly authorized by all necessary corporate action on the part of such party and no other corporate or stockholder proceedings or actions are necessary to authorize and consummate this Agreement, the Ancillary Agreements or the transactions contemplated hereby or thereby. This Agreement has been duly executed and delivered by the Seller and, assuming due authorization, execution and delivery by the Buyers, constitutes a valid and binding agreement of the Seller, enforceable against it in accordance with its terms, except as may be limited by applicable bankruptcy, insolvency, fraudulent conveyance, reorganization, moratorium and other similar Laws relating to or affecting creditors' rights generally and general equitable principles (whether considered in a Proceeding in equity or at law) (the "GENERAL ENFORCEABILITY EXCEPTIONS").

4.3 CAPITAL STOCK OF THE SELLER. The authorized capital stock of the Seller consists solely of 1,000 shares of common stock, par value $0.001 per share (the "COMMON STOCK"), itself consisting of (a) 100 shares of voting Common Stock, 18 of which are issued and

outstanding immediately prior to the effectiveness of this Agreement (the "OUTSTANDING VOTING COMMON STOCK") and (b) 900 shares of non-voting Common Stock, 162 of which are issued and outstanding immediately prior to the effectiveness of this Agreement (the "OUTSTANDING NON-VOTING COMMON STOCK" and, together with the Outstanding Voting Common Stock, the "OUTSTANDING STOCK"). The shares of Outstanding Stock represent the only issued and outstanding shares of capital stock of the Seller. All of the issued and outstanding shares of Outstanding Stock are owned, beneficially and of record, free and clear of any Liens, other than Permitted Liens, as set forth on SCHEDULE 4.3. All of the shares of Outstanding Stock were duly authorized and validly issued and are fully paid and nonassessable, and each issuance of such shares was in accordance with the requirements of all applicable federal and state securities laws. Except for this Agreement or as set forth on SCHEDULE 4.3, there are no outstanding subscriptions, options, warrants, calls, conversion or other rights, agreements, commitments, arrangements or understandings relating to the sale, issuance or voting of any shares of the capital stock of the Seller, or of any securities or other instruments convertible into, exchangeable for or evidencing the right to purchase any shares of capital stock of the Seller. There are no outstanding agreements or commitments obligating the Seller to repurchase, redeem or otherwise acquire any outstanding shares or other equity interests of the Seller. Concurrently with the execution of this Agreement, the Seller will issue the Shares to the Buyers free and clear of any Liens other than Liens created by or on behalf of the Buyers. Assuming the accuracy of the representations and warranties of the Buyers contained in ARTICLE V of this Agreement and that the offer, sale and issuance of the Shares is exempt from the registration requirements of the 1933 Act and all applicable state securities laws, the Shares that are being purchased by the Buyers hereunder, when issued, sold, and delivered in accordance with the terms of this Agreement for the consideration expressed herein, will be duly and validly issued, fully paid, and nonassessable, and will be free of restrictions on transfer other than restrictions on transfer contained in the Stockholders Agreement and under applicable state and federal securities laws.

4.4 CAPITAL STOCK OF THE COMPANY. The authorized capital stock of the Company consists solely of 1,000 shares of Common Stock, par value $0.001 per share, 1,000 of which are issued and outstanding (the "COMPANY STOCK"). The shares of Company Stock represent the only issued and outstanding shares of capital stock of the Company. All of the issued and outstanding shares of Company Stock are owned, beneficially and of record, free and clear of any Liens, other than Permitted Liens, by the Seller. All of the shares of Company Stock were duly authorized and validly issued and are fully paid and nonassessable, and each issuance of such shares was in accordance with the requirements of all applicable federal and state securities laws. Except as set forth on SCHEDULE 4.4, there are no outstanding subscriptions, options, warrants, calls, conversion or other rights, agreements, commitments, arrangements or understandings relating to the sale, issuance or voting of any shares of the capital stock of the Company, or of any securities or other instruments convertible into, exchangeable for or evidencing the right to purchase any shares of capital stock of the Company. There are no outstanding agreements or commitments obligating the Seller or the Company to repurchase, redeem or otherwise acquire any outstanding shares or other equity interests of the Company.

4.5 SUBSIDIARIES. The Seller does not own any equity interest in any Person other than the Company. The Company does not own any equity interest in any Person.

4.6 NO CONFLICTS OR APPROVALS.

(a) Except as set forth on SCHEDULE 4.6(A), the execution, delivery and performance by the Seller of this Agreement and the Ancillary Agreements to which it is a party, and the consummation by the Seller of the transactions contemplated hereby and thereby, do not and will not (i) violate, conflict with or result in a breach of the articles of incorporation or the bylaws of the Seller or of the Company, (ii) subject to the receipt of the Consents set forth on SCHEDULE 4.6(B), violate, conflict with or result in a breach of, or constitute a default by the Seller or the Company (or create an event which, with notice or lapse of time or both, would constitute a default) or give rise to any right of termination, cancellation or acceleration under, or result in the creation of any Lien, other than Permitted Liens, upon any of the properties or assets of the Seller or the Company, or on the Shares, under any Material Contract (as defined in that certain Asset Contribution and Assumption of Liabilities Agreement, dated as of December 31, 2005, by and among PolyOne Engineered Films, Inc., PolyOne and the Company), or (iii) subject to the receipt of the Consents set forth on SCHEDULE 4.6(B), violate any Law or order, writ, judgment, injunction or decree issued by any Governmental Authority (a "GOVERNMENTAL ORDER") applicable to the Seller or the Company, or any of their respective properties or assets, except as would not, individually or in the aggregate, have a Company Material Adverse Effect or a material adverse effect on the ability of the Seller to consummate the transactions contemplated by this Agreement.

(b) Except as set forth on SCHEDULE 4.6(B), no Consent is required to be obtained by the Seller for the consummation by the Seller of the transactions contemplated by this Agreement that if not obtained would have a Company Material Adverse Effect or a material adverse effect on the ability of the Seller to consummate the transactions contemplated by this Agreement.

4.7 PROCEEDINGS. As of the date of this Agreement, except as set forth on SCHEDULE 4.7, there are no Proceedings pending or, to the Knowledge of the Seller, threatened against the Seller or the Company that, if adversely decided, would have a material adverse effect on the ability of the Seller to consummate the transactions contemplated by this Agreement.

4.8 NO BROKERS' OR OTHER FEES. Except for KeyBanc Capital Markets, (a) no Person has been employed by or on behalf of the Seller as a broker, finder or investment banker in connection with the transactions contemplated hereby, and (b) no Person with which Seller has had any dealings or communications of any kind is entitled to any fee or commission or like payment in connection with the transactions contemplated hereby. No Buyer will be liable for any such fees, commissions, or like payments to KeyBanc Capital Markets.

4.9 NO OTHER REPRESENTATIONS OR WARRANTIES. Except for the representations and warranties contained in this ARTICLE IV, neither the Seller nor any other Person makes any other express or implied representation or warranty to the Buyers.

## ARTICLE V
## REPRESENTATIONS AND WARRANTIES OF THE BUYERS

Each of the Buyers hereby represents and warrants, severally and not jointly, to the Seller as follows:

5.1 ORGANIZATION. Such Buyer is a limited liability company duly formed, validly existing and in good standing under the Laws of its jurisdiction of formation. Such Buyer has the requisite limited liability company power and authority to own, lease and operate its assets and to carry on its business as now being conducted.

5.2 AUTHORIZATION; ENFORCEABILITY. Such Buyer has the requisite limited liability company power and authority to execute and deliver this Agreement and the Ancillary Agreements to which the Buyer is a party and perform its obligations hereunder and thereunder. The execution and delivery of this Agreement by such Buyer and the Ancillary Agreements to which such Buyer is a party and the performance by such Buyers of its obligations hereunder and thereunder have been duly authorized by all necessary limited liability company action on the part of such Buyer and, upon such authorization, no other limited liability company or equityholder proceedings or actions are necessary to authorize or consummate this Agreement, the Ancillary Agreements or the transactions contemplated hereby or thereby. This Agreement and the Ancillary Agreements to which such Buyer is a party have been duly executed and delivered by such Buyer and, assuming due authorization, execution and delivery by the Seller, constitute valid and binding agreements of such Buyer, enforceable against it in accordance with their terms, subject to the General Enforceability Exceptions.

5.3 NO APPROVALS OR CONFLICTS.

(a) The execution, delivery and performance by such Buyer of this Agreement and the Ancillary Agreements to which such Buyer is a party and the consummation by such Buyer of the transactions contemplated hereby and thereby do not and will not (i) violate, conflict with or result in a breach by such Buyer of the organizational documents of such Buyer, (ii) violate, conflict with or result in a breach of, or constitute a default by such Buyer (or create an event which, with notice or lapse of time or both, would constitute a default) or give rise to any right of termination, cancellation or acceleration under, or result in the creation of any Lien, other than a Permitted Lien, upon any of the properties or assets of such Buyer under, any material note, bond, mortgage, indenture, license, lease, contract, agreement or other instrument to which such Buyer or any of its properties or assets may be bound, or (iii) subject to the receipt of the requisite approvals referred to on SCHEDULE 5.3(A), violate any Governmental Order or Law applicable to such Buyer or any of its properties or assets, except as would not, individually or in the aggregate, have a Buyer Material Adverse Effect or a material adverse effect on the ability of such Buyer to consummate the transactions contemplated by this Agreement.

(b) Except as set forth on SCHEDULE 5.3(B), no Consent is required to be obtained by such Buyer for the consummation by such Buyer of the transactions contemplated by this Agreement or the Ancillary Agreements to which such Buyer is a party.

5.4 PROCEEDINGS. Except as set forth on SCHEDULE 5.4, there are no Proceedings pending or, to the Knowledge of the Buyers, threatened against such Buyer or any

of its Affiliates that would reasonably be expected to have a material adverse effect on the ability of such Buyer to consummate the transactions contemplated by this Agreement or the Ancillary Agreements to which such Buyer is a party. Except as set forth on SCHEDULE 5.4, such Buyer is not subject to any Governmental Order that would reasonably be expected to have a material adverse effect on the ability of such Buyer to consummate the transactions contemplated by this Agreement or the Ancillary Agreements to which such Buyer is a party.

5.5 NO BROKERS' OR OTHER FEES. Except for Matrix Capital Markets Group, Inc., (a) no Person has been employed by or on behalf of such Buyer as a broker, finder or investment banker in connection with the transactions contemplated hereby, and (b) no Person with which such Buyer has had any dealings or communications of any kind is entitled to any fee or commission or like payment in connection with the transactions contemplated hereby. The Seller will not be liable for any such fees, commissions, or like payments to Matrix Capital Markets Group, Inc.

5.6 INVESTMENT INTENT. Such Buyer is acquiring its Shares for the Buyer's own accounts for investment and not with a view to or for sale in connection with any distribution thereof other than in compliance with the 1933 Act. Such Buyer is aware that there are limitations and restrictions on the circumstances under which the Buyers may offer to sell, transfer or otherwise dispose of the Shares, so that it might not be possible to liquidate this investment readily and it may be necessary to hold the Shares for an indefinite period. Such Buyer agrees that it will not transfer any of the Shares, except in compliance with the 1933 Act. Such Buyer further understands and acknowledges that the Shares have not been registered under the 1933 Act and agrees that the Shares may not be transferred unless (a) such transfer is pursuant to an effective registration statement under the 1933 Act or (b) such transfer is exempt from the provisions of Section 5 of the 1933 Act. Such Buyer agrees that the Shares will not be offered for sale, sold, transferred, or otherwise disposed of by such Buyer without compliance with the terms and conditions of the Stockholders' Agreement, as amended from time to time, and applicable federal and state securities laws.

5.7 ABILITY TO BEAR RISK; SOPHISTICATION; INQUIRY. The financial situation of such Buyer is such that (a) it can afford to bear the economic risk of holding the Shares for an indefinite period and (b) it can afford to suffer the complete loss of its investment in the Shares. Such Buyer acknowledges that it has such knowledge and experience in financial and business matters that it is capable of evaluating the merits and risks of the proposed investment. Such Buyer is familiar with the type of investment that the Shares constitutes, and has reviewed the purchase of the Shares subscribed for herein with tax and legal counsel to the extent that such Buyer has deemed such review advisable. Such Buyer has been provided, to its satisfaction, the opportunity to ask questions concerning the Company and the Seller and the terms and conditions of the offering of the Shares. Such Buyer has had all such questions answered to its satisfaction, and has been supplied all additional information deemed necessary by it to verify the accuracy of the information furnished. Such Buyer acknowledges that the Seller is specifically relying on these representations in connection with the consummation of the transactions contemplated by this Agreement. Such Buyer also acknowledges that all information that such Buyer has provided concerning itself and its financial position is true and correct in all material respects.

5.8 ACCREDITED INVESTOR. Such Buyer is an "accredited investor" as defined in Rule 501(a) of Regulation D promulgated under the 1933 Act.

5.9 FINANCING. Such Buyer has sufficient funds available to deliver its respective portion of the Purchase Price and to consummate the transactions contemplated by this Agreement.

5.10 NO RELIANCE. Such Buyer or its representatives have inspected and conducted such reasonable review and analysis (financial and otherwise) of the Company as desired by such Buyer. The Subscriptions and the consummation of the transactions contemplated hereunder and under the Ancillary Agreements by such Buyer are not done in reliance upon any warranty or representation by, or information from, the Seller or the Company of any sort, oral or written, except the warranties and representation specifically set forth in this Agreement (including the Disclosure Schedules and Exhibits hereto) and in any certificates required to be delivered to such Buyer by the Seller or the Company hereunder and thereunder. Such purchase and consummation are instead done entirely on the basis of the Buyer's own investigation, analysis, judgment and assessment of the present and potential value and earning power of the Seller and the Company as well as those representations and warranties by the Seller or the Company specifically set forth in this Agreement (including the Disclosure Schedules and Exhibits hereto) and in any certificates required to be delivered to such Buyer by the Seller or the Company hereunder and thereunder.

5.11 PROMISSORY NOTE. The Promissory Note to be issued under this Agreement, when issued by the Management Investor to the Seller pursuant to the terms of this Agreement, will have been issued in compliance with all applicable federal and state securities laws, and will be free and clear of all Liens.

5.12 NO OTHER REPRESENTATIONS OR WARRANTIES. Except for the representations and warranties contained in this ARTICLE V, neither such Buyer nor any other Person makes any other express or implied representation or warranty to the Seller.

## ARTICLE VI
## COVENANTS AND AGREEMENTS

6.1 TRANSFER TAXES. The Buyers, on the one hand, and the Seller, on the other hand, shall each pay one-half of all transfer, documentary, sales, use, registration and other such Taxes (including all applicable real estate transfer Taxes, but excluding any Taxes based on or attributable to income or gains) and related fees (including any penalties, interest and additions to Tax) ("TRANSFER TAXES") arising out of or incurred in connection with this Agreement.

6.2 CONFIDENTIALITY. Following the date of this Agreement, all proprietary information obtained at any time in connection with this Agreement or the transactions contemplated hereby (including without limitation any information obtained in due diligence therefor) by the Buyers from or on behalf of the Company, the Seller, PolyOne, or PolyOne's Affiliates will be kept confidential and will not be disclosed by the Buyer; provided, that the foregoing restriction does not apply to information that (a) is lawfully and independently obtained by the Buyers from a third party without restriction as to disclosure by the Buyers, (b)

was known by the Buyers prior to its disclosure by or on behalf of the Company, the Seller, PolyOne, or PolyOne's Affiliates, (c) is in the public domain or enters into the public domain through no fault of the Buyers, (d) is independently developed by the Buyers without reference to proprietary information provided by or on behalf of the Company, the Seller, PolyOne, or PolyOne's Affiliates, or (e) the Buyers are required by law or legal process to disclose.

6.3 INJUNCTIVE RELIEF; LIMITATION ON SCOPE. The Buyers acknowledge that any breach or threatened breach of the provisions of SECTION 6.2 of this Agreement may cause irreparable injury to the Seller or the Company for which an adequate monetary remedy does not exist. Accordingly, in the event of any such breach or threatened breach, the Seller and the Company shall be entitled, in addition to the exercise of other remedies, to injunctive relief, without necessity of posting a bond, restraining the Buyers from committing such breach or threatened breach. The rights provided under this SECTION 6.3 shall be in addition to, and not in lieu of, any other rights and remedies available to the Seller and the Company.

## ARTICLE VII
## INDEMNIFICATION

7.1 INDEMNIFICATION BY THE SELLER. Subject to the terms and conditions set forth in this ARTICLE VII, from and after the date of this Agreement, the Seller shall indemnify and hold harmless the Buyers, their Affiliates (other than the Seller), and their respective officers, directors, shareholders, employees, agents and representatives (collectively, the "BUYER INDEMNIFIED PERSONS"), from and against any and all Losses actually sustained by any Buyer Indemnified Person based upon the failure of or any breach of any (a) representation or warranty by the Seller contained in this Agreement to be true and correct on the date of this Agreement or (b) any covenant or agreement of the Seller.

7.2 INDEMNIFICATION BY THE BUYERS. Subject to the terms and conditions set forth in this ARTICLE VII, from and after the Closing Date, each Buyer, severally and not jointly, shall indemnify and hold harmless the Seller, its Affiliates, and their respective officers, directors, shareholders, employees, agents, and representatives (collectively, the "SELLER INDEMNIFIED PERSONS"), from and against any and all Losses actually sustained by the Seller Indemnified Person based upon the failure of or any breach of any (a) representation or warranty by such Buyer contained in this Agreement to be true and correct on the date of this Agreement or (b) any covenant or agreement of such Buyer.

7.3 INDEMNIFICATION AS EXCLUSIVE REMEDY. All representations, warranties, covenants and obligations in this Agreement and any other certificate or document delivered pursuant to this Agreement will survive the date of this Agreement and the consummation of the transactions contemplated hereby and thereby. The indemnification provided for in this ARTICLE VII, subject to the limitations set forth herein, is the exclusive post-Closing remedy available to any party in connection with any Losses arising out of the matters set forth in this Agreement or the transactions contemplated under this Agreement.

7.4 LIMITATIONS ON INDEMNIFICATION.

(a) The right to indemnification of a Buyer Indemnified Person under SECTION 7.1(A) will be reduced by (i) any third party insurance proceeds received by or payable to, or (ii)

any tax benefits actually realized by, (x) the Buyer Indemnified Person or (y) the Company or the Seller, as applicable, provided that such reduction will be equal to the product of the Buyers' percentage ownership of the capital stock of the Seller at the time of the Loss and the dollar amount of the proceeds actually received by or payable to, or the tax benefits actually realized by, the Company or the Seller, as applicable. If a Buyer Indemnified Person receives such insurance proceeds in connection with such Losses for which it has received indemnification, the Buyers shall refund to the Seller or the Company, as applicable, the amount of such insurance proceeds when received, up to the amount of indemnification received. A Buyer Indemnified Person shall use all good faith efforts to pursue third party insurance claims with respect to any such Losses. The parties agree that any indemnification payments made pursuant to this Agreement will be treated for tax purposes as an adjustment to the Purchase Price, unless otherwise required by Law.

(b) No Indemnified Party will be entitled to indemnification pursuant to this ARTICLE VII for punitive damages, or for lost profits, consequential, indirect, exemplary or special damages.

7.5 PROCEDURES.

(a) Notice of Losses. As soon as is reasonably practicable after the Seller or either of the Buyers has actual knowledge of any Losses for which indemnification is available under SECTION 7.1(A) or SECTION 7.2 (a "CLAIM"), such party shall give written notice thereof (a "CLAIM NOTICE") to the other parties. A Claim Notice must describe the Claim in reasonable detail, and must indicate the amount (estimated as necessary and to the extent feasible) of the Loss that has been or will be suffered by the Indemnified Party. No delay in or failure to give a Claim Notice by the Indemnified Party to the Indemnifying Party will adversely affect any other rights or remedies that the Indemnified Party has under this Agreement, or alter or relieve the Indemnifying Party of its obligations to indemnify the Indemnified Party to the extent that such delay or failure has not materially prejudiced the Indemnifying Party.

(b) Third Party Claims.

(i) If any Claim Notice identifies any Claim brought by a third person (a "THIRD PARTY CLAIM"), the Indemnifying Party will have the right, exercisable by written notice to the Indemnified Party, to assume the defense of such Third Party Claim, with counsel selected by the Indemnifying Party. If the Indemnifying Party assumes the defense of such Third Party Claim, the Indemnifying Party will not be liable to the Indemnified Party for any legal expenses of other counsel or any other expenses subsequently incurred by such Indemnified Party in connection with the defense thereof and the Indemnified Party will have the right to participate at its own expense in the defense of such Third Party Claim. If the Indemnifying Party does not assume the defense of such Third Party Claim, the Indemnified Party may defend such Third Party Claim at the sole cost of the Indemnifying Party and the Indemnifying Party may still participate in, but not control, the defense of such Third Party Claim at the Indemnifying Party's sole cost and expense.

(ii) The party responsible for the defense of any Third Party Claim (a "RESPONSIBLE PARTY") shall, to the extent reasonably requested by the other party, keep

such other party informed as to the status of such Third Party Claim, including all settlement negotiations and offers. With respect to a Third Party Claim for which the Seller is the Responsible Party, the Buyers shall use all reasonable efforts to make available to the Seller all books and records of the Buyers relating to such Third Party Claim and shall cooperate with the Seller in the defense of the Third Party Claim. No settlement or compromise of any Third Party Claim may be effected (A) by the Indemnifying Party without the written consent of the Indemnified Party (which consent may not be unreasonably withheld or delayed) unless all relief provided is paid or satisfied in full by the Indemnifying Party or (B) by the Indemnified Party without the consent of the Indemnifying Party. In no event will an Indemnifying Party be liable for any settlement effected without its prior written consent.

## ARTICLE VIII
## MISCELLANEOUS

8.1 FEES AND EXPENSES. Except as otherwise provided in this Agreement and the Ancillary Agreements, each of the Seller and the Buyers shall bear their own expenses and the expenses of their Affiliates in connection with the preparation and negotiation of this Agreement and the Ancillary Agreements and the consummation of the transactions contemplated by this Agreement and the Ancillary Agreements. Each of the Seller and the Buyers shall bear the fees and expenses of any broker or finder retained by such party and its respective Affiliates in connection with the transactions contemplated by this Agreement and the Ancillary Agreements.

8.2 GOVERNING LAW. This Agreement will be construed under and governed by the Laws of the State of Delaware applicable to contracts made and to be performed in the State of Delaware.

8.3 PROJECTIONS. In connection with the Buyers' investigation of the Seller, the Company and the EFG Business, the Buyers may have received from the Seller, the Company and/or their respective representatives certain projections and other forecasts for the EFG Business, and certain business plan and budget information. The Buyers acknowledge that (a) there are uncertainties inherent in attempting to make such projections, forecasts, plans and budgets, (b) the Buyers are familiar with such uncertainties, (c) the Buyers are taking full responsibility for making their own evaluation of the adequacy and accuracy of all estimates, projections, forecasts, plans and budgets so furnished to them, and (d) the Buyers will not assert any claim against the Seller or any of its directors, officers, employees, Affiliates or representatives, or hold the Seller or any such Persons liable, with respect thereto. Accordingly, the Buyers acknowledge that the Seller makes no representation or warranty with respect to such projections, forecasts or plans and that the Seller makes only those representations and warranties explicitly set forth in ARTICLE IV.

8.4 AMENDMENT. This Agreement may be amended only with the written consent of the parties hereto.

8.5 ASSIGNMENT. Neither this Agreement nor any of the rights, interests or obligations hereunder may be assigned by any party hereto without the prior written consent of the other parties. Subject to the preceding sentence, this Agreement will be binding upon, inure

to the benefit of and be enforceable by, the parties hereto and their respective successors and permitted assigns, and is not intended to confer upon any Person other than the parties hereto and their respective successors and permitted assigns any rights or remedies hereunder.

8.6 WAIVER. Any of the terms or conditions of this Agreement that may be lawfully waived may be waived in writing at any time by any party that is entitled to the benefits thereof. Any waiver of any of the provisions of this Agreement by any party hereto will be binding only if set forth in an instrument in writing signed on behalf of such party. No failure to enforce any provision of this Agreement will be deemed to or will constitute a waiver of such provision and no waiver of any of the provisions of this Agreement will be deemed to or will constitute a waiver of any other provision hereof (whether or not similar) nor will such waiver constitute a continuing waiver.

8.7 NOTICES.

(a) Any notice, demand, or communication required or permitted to be given by any provision of this Agreement must be in writing and will be deemed to have been sufficiently given or served for all purposes if (i) personally delivered, (ii) sent by a nationally recognized overnight courier service to the recipient at the address below indicated, (iii) sent by registered or certified mail, return receipt requested, postage prepaid, or (iv) delivered by facsimile with confirmation of receipt:

If to the Equity Investor:

Matrix Capital Markets Group, Inc.
11 South 12th Street, 3rd Floor
Richmond, Virginia 23219
Attn: Bill Weirich
Telephone: (804) 780-0060
Telecopy: (804) 780-0158

If to the Management Investor:

O'Sullivan Films Management, LLC
1944 Valley Avenue
Winchester, Virginia 22601
Attn: President
Telephone: (540) 667-6666
Telecopy: (540) 722-2695

With a copy to:

LeClair Ryan, A Professional Corporation
123 East Main Street
8th Floor
Charlottesville, Virginia 22902
Attn: Michael P. Drzal, Esq.
Telephone: (434) 245-3431
Telecopy: (434) 296-0905

If to the Seller:

PolyOne Corporation
c/o O'Sullivan Films Holding Corporation
33587 Walker Road
Avon Lake, Ohio 44012
Attn: Chief Legal Officer
Telephone: 440-930-1000
Telecopy: 440-930-1002

With a copy to:

Jones Day
North Point
901 Lakeside Avenue
Cleveland, Ohio 44114
Attn: Denise Carkhuff, Esq.
Telephone: 216-586-3939
Telecopy: 216-579-0212

or to such other address as any party hereto may, from time to time, designate in a written notice given in like manner.

(b) Except as otherwise provided herein, any notice under this Agreement will be deemed to have been given (i) on the date such notice is personally delivered or delivered by facsimile, (ii) the next succeeding Business Day after the date such notice is delivered to the overnight courier service if sent by overnight courier, or (iii) five Business Days after the date such notice is sent by registered or certified mail.

8.8 COMPLETE AGREEMENT. This Agreement and any confidentiality agreement by and between PolyOne and Matrix Capital Markets Group, Inc., together with the Exhibits, Disclosure Schedules, Ancillary Agreements, certificates and other documents and instruments delivered hereunder, contain the entire understanding of the parties with respect to the subject matter hereof and thereof and supersede all prior agreements and understandings, both written and oral, between the parties with respect to the subject matter hereof and thereof

8.9 COUNTERPARTS. This Agreement may be executed in one or more counterparts, all of which will be considered one and the same agreement and each of which will be deemed an original.

8.10 PUBLICITY. The Seller and the Buyers shall consult with each other and shall mutually agree upon any publication or press release of any nature with respect to this Agreement or the transactions contemplated hereby and shall not issue any such publication or press release prior to such consultation and agreement except as may be required by Law or by obligations pursuant to any listing agreement with any securities exchange or any securities exchange regulation, in which case the party proposing to issue such publication or press release shall make all good faith efforts to consult and agree with the other party or parties before

issuing any such publication or press release and shall provide a copy thereof to the other party or parties prior to such issuance.

8.11 HEADINGS. The headings contained in this Agreement are for reference only and do not affect in any way the meaning or interpretation of this Agreement.

8.12 SEVERABILITY. If any term, provision, agreement, covenant or restriction of this Agreement or the application of any term, provision, covenant or restriction of this Agreement to any party or circumstance is finally adjudged invalid, ineffective, null, void or unenforceable, the application of the remainder of such term, provision, agreement, covenant or restriction to such party or circumstance, the application of such term, provision, agreement, covenant or restriction to other parties or circumstances, and the application of the remainder of the terms, provisions, agreements, covenants and restrictions of this Agreement will remain in full force and effect and will in no way be affected, impaired or invalidated so long as the economic or legal substance of the transactions contemplated hereby is not affected in any manner materially adverse to any party hereto. The invalid, ineffective, null, void or unenforceable provision will, without further action by the parties, be automatically amended to effect the original purpose and intent of the invalid, ineffective, null, void or unenforceable provision; provided, however, that such amendment will apply only with respect to the operation of such provision in the particular jurisdiction in which such adjudication is made.

8.13 THIRD PARTIES. Nothing herein expressed or implied is intended or will be construed to confer upon or give to any Person, other than the parties hereto and their permitted successors or assigns, any rights or remedies under or by reason of this Agreement.

8.14 FURTHER ASSURANCES. The parties shall execute such further instruments and take such further actions as may be reasonably necessary to carry out the intent of this Agreement. Each party hereto shall cooperate affirmatively with the other parties, to the extent reasonably requested by such other parties, to enforce rights and obligations herein provided.

8.15 ARBITRATION. All disputes under this Agreement must be resolved pursuant to an arbitration before, and according to the rules and procedures of the American Arbitration Association ("AAA") before a three-neutral panel sitting in Cleveland, Ohio. The following procedure will apply in such arbitration:

(a) The party seeking arbitration shall make application with AAA for arbitration, attaching these provisions to the request, with concurrent notice to the other party. Such party shall attach this Agreement to the application, and set forth in detail the precise issues and matters the applicant wishes to have the arbitrators decide, all to enable the AAA to better determine which arbitrators' qualifications best qualify them to serve on a panel. The AAA shall nominate an odd number of arbitrators having the experience and qualifications with the subject matter of the arbitration reasonably qualifying them to serve, but in no event less than seven potential arbitrators.

(b) The parties shall strike arbitrators from the listing until only three remain, with the party requesting arbitration striking first. If a selected arbitrator(s) cannot serve for any reason, the last struck arbitrator(s) will serve in his or her place and stead.

(c) Initially each party to this Agreement shall submit a detailed, comprehensive proposal for resolving the matter being arbitrated. The arbitrators may allow the parties, in the discretion of the panel, to support their proposal through briefing, testimony and oral argument. The arbitrators shall select the proposed resolution put forth by one of the parties as their decision; the arbitrators have no authority to modify that proposed resolution.

(d) The decision of a majority of the panel will determine the arbitration, and constitute a final and binding determination of the matter arbitrated, which either party may enforce in a court of law having competent venue over the other party.

8.16 CONSENT TO JURISDICTION; WAIVER OF JURY TRIAL. Each of the parties irrevocably submits to the exclusive jurisdiction of the courts of the State of Delaware, for the purposes of any Proceeding arising out of this Agreement or any transaction contemplated hereby. Each of the parties hereto irrevocably and fully waives the defense of an inconvenient forum to the maintenance of such Proceeding. Each of the parties further agrees that service of any process, summons, notice or document to such party's respective address listed above in one of the manners set forth in SECTION 8.7 will be deemed in every respect effective service of process in any such Proceeding, and waives any objection it might otherwise have to service of process under Law. Nothing herein will affect the right of any Person to serve process in any other manner permitted by Law. The parties hereto hereby irrevocably and unconditionally waive trial by jury in any Proceeding relating to this Agreement or any other agreement entered into in connection therewith and for any counterclaim with respect thereto.

[REMAINDER OF PAGE INTENTIONALLY LEFT BLANK]

IN WITNESS WHEREOF, each of the parties hereto has caused this Agreement to be executed by its duly authorized officer, in each case as of the date first above written.

O'SULLIVAN FILMS HOLDING
CORPORATION

By:
------------------------------------
Name: John L. Rastetter
Title: Vice President, Finance

MATRIX FILMS, LLC

By
-------------------------------------
Name:
----------------------------------
Title:
---------------------------------

O'SULLIVAN FILMS MANAGEMENT, LLC

By
-------------------------------------
Name:
----------------------------------
Title:
---------------------------------

.
.
.

EXHIBIT 21.1

# POLYONE CORPORATION SUBSIDIARIES

| NAME | FORMATION JURISDICTION |
|---|---|
| 1997 Chloralkali Venture, Inc. | Alabama |
| 1999 General Compounding Partnership, Inc. | Delaware |
| 1999 Limited Compounding Partnership, Inc. | Delaware |
| 1999 PVC Partner, Inc. | Delaware |
| Altona Properties Pty Ltd. (37.4% owned) | Australia |
| Auseon Limited | Australia |
| BayOne Urethane Systems, LLC (50% owned) | Delaware |
| Compounding Technology, Euro S.A | France |
| Conexus, Inc. | Nevada |
| DH Compounding Company (50% owned) | Delaware |
| Geon Development, Inc. | Ohio |
| Geon Polimeros Andios S.A. (51% owned) | Colombia |
| Hanna France SARL | France |
| Hanna PAR Corporation | Delaware |
| Hanna Deutschland, GmbH | Germany |
| Hollinger Development Company | Nevada |
| L. E. Carpenter & Company | Delaware |
| Lincoln & Southern Railroad Company | Delaware |
| LP Holdings | Canada |
| M.A. Hanna Asia Holding Company | Delaware |
| M.A. Hanna Export Services Company | Barbados |
| M.A. Hanna Plastic Group, Inc. | Michigan |
| M.A. Hanna International Financial Services Company | Ireland |
| M.A. Hanna de Mexico, S.A. de C.V. | Mexico |
| M.A. Hanna U.K. Ltd | England |
| MAH Plastics Company | Delaware |
| O'Sullivan Plastics Corporation | Nevada |
| O'Sullivan Films, Inc. | Delaware |
| O'Sullivan Films Holding Corporation | Delaware |
| Oxy Vinyls, LP (24% owned) | Delaware |
| Polymer Diagnostics, Inc. | Ohio |
| PolyOne, LLC | Delaware |
| PolyOne Belgium SA | Belgium |
| PolyOne Canada, Inc. | Canada |
| PolyOne Color and Additives Germany, GmbH | Germany |
| PolyOne Corporation UK Limited | England |

| | |
|---|---|
| PolyOne Distribution de Mexico S.A. de C.V. | Mexico |
| PolyOne Engineered Films, Inc. | Virginia |
| PolyOne Engineering Vinyls UK, Ltd. | England |
| PolyOne Funding Corporation | Delaware |
| PolyOne International Trading (Shanghai) Co., Ltd. | China |
| PolyOne Spain, S.A. | Spain |
| PolyOne France S.A.S | France |
| PolyOne Hungary, Ltd. | Hungary |
| PolyOne Norway, A.S. | Norway |
| PolyOne-Shenzhen Co. Ltd. | China |
| PolyOne Shanghai, China | China |
| PolyOne Singapore, Ltd. | Singapore |
| PolyOne-Suzhou, China | China |
| PolyOne Sweden, AB | Sweden |
| PolyOne Th. Bergmann, GmbH | Germany |
| PolyOne Wilflex Europe, Ltd. | England |
| PVC Powder Blends LP (90% owned) | Delaware |
| Regalite Plastics Corporation | Massachusetts |
| Shawnee Holdings, Inc. | Virginia |
| Star Color Co. Ltd. | Thailand |
| Sunbelt Chlor-Alkali Partnership (50% owned) | Delaware |
| Tekno Polimer Group | Turkey |
| TRANSCOLOR, S.A. | Spain |
| UBE-Hanna Compounding GmbH | Germany |
| Welvic Australia Pty. Ltd. (37.4% owned) | Australia |
| PolyOne Wilflex Australasia Pty. Ltd. | Australia |

EXHIBIT 23.1

# CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in the Registration Statement (Form S-8 No. 333-128283) pertaining to the 2005 Equity and Performance Incentive Plan, in the Registration Statement (Form S-8 No. 333-47796) pertaining to Post Effective Amendment No. 2 on Form S-8 to Form S-4 and in the Registration Statement (Form S-8 No. 333-48002) pertaining to the PolyOne Corporation 2000 Stock Incentive Plan of our reports dated February 24, 2006, with respect to the consolidated financial statements and schedule of PolyOne Corporation, PolyOne Corporation management's assessment of the effectiveness of internal control over financial reporting, and the effectiveness of internal control over financial reporting of PolyOne Corporation, included in this Annual Report (Form 10-K) for the year ended December 31, 2005.

/s/ ERNST & YOUNG LLP

Cleveland, Ohio
March 14, 2006

EXHIBIT 23.2

## CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in the registration statement (No. 333-48002, 333-47796 and 333-128283) on Form S-8 of PolyOne Corporation of our report dated February 28, 2006, with respect to the consolidated balance sheets of Oxy Vinyls, LP as of December 31, 2005 and 2004, and the related consolidated statements of operations, changes in partners' capital, and cash flows for each of the years in the three-year period ended December 31, 2005, which report appears in the December 31, 2005, annual report on Form 10-K of PolyOne Corporation.

KPMG LLP

Dallas, Texas

March 15, 2006

EXHIBIT 23.3

# CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in the Registration Statement (Form S-8 No. 333-128283) pertaining to the 2005 Equity and Performance Incentive Plan, in the Registration Statement (Form S-8 No. 333-47796) pertaining to Post Effective Amendment No. 2 on Form S-8 to Form S-4 and in the Registration Statement (Form S-8 No. 333-48002) pertaining to the PolyOne Corporation 2000 Stock Incentive Plan of our report dated February 10, 2006, with respect to the financial statements of SunBelt Chlor Alkali Partnership included in the Annual Report (Form 10-K) of PolyOne Corporation for the year ended December 31, 2005.

/s/ ERNST & YOUNG LLP

Cleveland, Ohio
March 14, 2006

EXHIBIT 31.1

CERTIFICATION

I, Stephen D. Newlin, President, Chief Executive Officer and Chairman of the Board of PolyOne Corporation ("registrant"), certify that:

1. I have reviewed this report on Form 10-K of PolyOne Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented our conclusions in this report about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Stephen D. Newlin

- -------------------------------------------------------------

Stephen D. Newlin
President, Chief Executive Officer and Chairman of the Board
March 15, 2006

EXHIBIT 31.2

CERTIFICATION

I, W. David Wilson, Vice President and Chief Financial Officer of PolyOne Corporation ("registrant"), certify that:

1. I have reviewed this report on Form 10-K of PolyOne Corporation;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

   (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

   (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

   (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented our conclusions in this report about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

   (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

   (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

   (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ W. David Wilson

- -------------------------------------------

W. David Wilson<br>
Vice President and Chief Financial Officer<br>
March 15, 2006

EXHIBIT 32.1

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report on Form 10-K of PolyOne Corporation (the "Company") for the period ended December 31, 2005, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Stephen D. Newlin, President, Chief Executive Officer and Chairman of the Board, do hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of the dates and for the periods expressed in the Report.

/s/ Stephen D. Newlin
- ---------------------------------------------------------------
Stephen D. Newlin
President, Chief Executive Officer and Chairman of the Board
March 15, 2006

The foregoing certification is being furnished solely pursuant to 18 U.S.C. Section 1350 and is not being filed as part of the Report or as a separate disclosure document.

EXHIBIT 32.2

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Annual Report on Form 10-K of PolyOne Corporation (the "Company") for the period ended December 31, 2005, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, W. David Wilson, Vice President and Chief Financial Officer of the Company, do hereby certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to the best of my knowledge:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of the dates and for the periods expressed in the Report.

/s/ W. David Wilson
- -------------------------------------------
W. David Wilson
Vice President and Chief Financial Officer
March 15, 2006

The foregoing certification is being furnished solely pursuant to 18 U.S.C. Section 1350 and is not being filed as part of the Report or as a separate disclosure document.

Exhibit 99.1

# OXY VINYLS, LP AND SUBSIDIARIES

## Consolidated Financial Statements

December 31, 2005 and 2004

(With Independent Auditors' Report Thereon)

# Report of Independent Registered Public Accounting Firm

To the Partners
Oxy Vinyls, LP:

We have audited the accompanying consolidated balance sheets of Oxy Vinyls, LP and subsidiaries (the Partnership) as of December 31, 2005 and 2004, and the related consolidated statements of operations, changes in partners' capital, and cash flows for each of the years in the three-year period ended December 31, 2005. These consolidated financial statements are the responsibility of the Partnership's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards as established by the Auditing Standards Board (United States) and in accordance with the auditing standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Partnership is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Partnership's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Oxy Vinyls, LP and subsidiaries as of December 31, 2005 and 2004, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2005, in conformity with U.S. generally accepted accounting principles.

As explained in Note 3 to the financial statements, effective January 1, 2003, the Partnership changed its method of accounting for asset retirement obligations. In addition, as explained in Note 2 to the financial statements, effective April 1, 2003, the Partnership changed its method of accounting for the consolidation of variable interest entities. Furthermore, as explained in Note 3 to the financial statements, effective July 1, 2005, the Partnership changed its method of accounting for share-based payments.

KPMG LLP

Dallas, Texas

February 28, 2006

OXY VINYLS, LP AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

December 31, 2005 and 2004

(Amounts in thousands)

| | 2005 | 2004 |
|---|---|---|
| ASSETS | | |
| CURRENT ASSETS: | | |
| Cash and cash equivalents | $ 963 | $ 25 |
| Trade receivables, net of reserves of $1,944 in 2005 | 248,979 | 77,660 |
| Other receivables | 11,747 | 4,119 |
| Receivable from OXY Receivables Corporation, net | -- | 172,147 |
| Receivable from PolyOne Corporation, net | 27,952 | -- |
| Inventories | 166,721 | 133,940 |
| Prepaid expenses | 10,905 | 3,567 |
| Total current assets | 467,267 | 391,458 |
| PROPERTY, PLANT AND EQUIPMENT, net | 1,223,301 | 1,353,923 |
| OTHER ASSETS, net | 11,542 | 14,378 |
| | $1,702,110 | $1,759,759 |
| LIABILITIES AND PARTNERS' CAPITAL | | |
| CURRENT LIABILITIES: | | |
| Current maturities of long-term debt | $ 8,250 | $ -- |
| Current maturities of note payable to Occidental Chemical Corporation | 9,964 | -- |
| Current maturities of loans payable to Occidental Petroleum Corporation | 13,700 | -- |
| Accounts payable | 108,345 | 121,008 |
| Accrued liabilities | 69,978 | 53,225 |
| Accrued property taxes | 17,525 | 17,015 |
| Foreign income taxes payable | 431 | 152 |
| Payable to Occidental Chemical Corporation, net | 47,767 | 51,877 |
| Payable to PolyOne Corporation, net | -- | 1,043 |
| Total current liabilities | 275,960 | 244,320 |
| LONG-TERM DEBT, net of current maturities | 156,383 | 164,597 |
| NOTE PAYABLE TO OCCIDENTAL CHEMICAL CORPORATION | -- | 9,964 |
| LOANS PAYABLE TO OCCIDENTAL PETROLEUM CORPORATION, net | 120,342 | 250,676 |
| POSTRETIREMENT BENEFIT OBLIGATIONS | 29,469 | 24,529 |
| ASSET RETIREMENT OBLIGATIONS | 14,453 | 13,316 |
| DEFERRED CREDITS AND OTHER LIABILITIES | 7,747 | 8,275 |
| COMMITMENTS AND CONTINGENCIES (NOTE 10) | | |
| MINORITY INTEREST IN OXYMAR | 47,662 | 11,339 |
| PARTNERS' CAPITAL | 1,050,094 | 1,032,743 |
| | $1,702,110 | $1,759,759 |

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

OXY VINYLS, LP AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

For the Years Ended December 31, 2005 and 2004 and 2003

(Amounts in thousands)

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| REVENUES: | | | |
| Net sales | $2,501,986 | $2,272,508 | $1,760,373 |
| Equity in losses of unconsolidated subsidiary | -- | -- | (3,146) |
| | 2,501,986 | 2,272,508 | 1,757,227 |
| COSTS AND OTHER DEDUCTIONS: | | | |
| Cost of sales | 2,171,907 | 1,974,155 | 1,586,725 |
| Selling, general and administrative and other operating expenses, net | 29,559 | 31,289 | 52,844 |
| Restructuring and asset writedowns | 104,686 | -- | -- |
| Interest expense, net | 26,741 | 30,273 | 19,468 |
| INCOME BEFORE MINORITY INTEREST, INCOME TAXES AND ACCOUNTING CHANGE | 169,093 | 236,791 | 98,190 |
| Minority interest | 36,321 | 38,191 | 201 |
| INCOME BEFORE TAXES AND ACCOUNTING CHANGE | 132,772 | 198,600 | 97,989 |
| Provision (benefit) for income taxes | 2,921 | (1,158) | 2,196 |
| INCOME BEFORE ACCOUNTING CHANGE | 129,851 | 199,758 | 95,793 |
| Cumulative effect of accounting change, net | -- | -- | (3,441) |
| NET INCOME | $ 129,851 | $ 199,758 | $ 92,352 |

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

OXY VINYLS, LP AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN PARTNERS' CAPITAL

For the Years Ended December 31, 2005 and 2004 and 2003

(Amounts in thousands)

| | Occidental PVC LP Inc. | Occidental PVC LLC | 1999 PVC Partner Inc. | Total Partners' Capital |
|---|---|---|---|---|
| Balance at December 31, 2002 | $ 756,687 | $10,089 | $242,140 | $1,008,916 |
| Net income | 69,264 | 924 | 22,164 | 92,352 |
| Distributions to partners | (60,000) | (800) | (19,200) | (80,000) |
| Balance at December 31, 2003 | 765,951 | 10,213 | 245,104 | 1,021,268 |
| Net income | 149,818 | 1,998 | 47,942 | 199,758 |
| Distributions to partners | (141,212) | (1,879) | (45,192) | (188,283) |
| Balance at December 31, 2004 | 774,557 | 10,332 | 247,854 | 1,032,743 |
| Net income | 97,388 | 1,298 | 31,165 | 129,851 |
| Distributions to partners | (84,375) | (1,125) | (27,000) | (112,500) |
| Balance at December 31, 2005 | $ 787,570 | $10,505 | $252,019 | $1,050,094 |

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

OXY VINYLS, LP AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Years Ended December 31, 2005 and 2004 and 2003

(Amounts in thousands)

| | 2005 | 2004 | 2003 |
|---|---|---|---|
| CASH FLOW FROM OPERATING ACTIVITIES: | | | |
| Net income | $ 129,851 | $ 199,758 | $ 92,352 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation and amortization | 122,587 | 123,044 | 99,371 |
| Equity in losses of unconsolidated subsidiary | -- | -- | 3,146 |
| Decrease in deferred foreign income taxes | -- | (3,099) | (339) |
| Minority interest | 36,321 | 38,192 | 201 |
| Other noncash charges to income | 5,820 | 3,170 | 5,516 |
| Loss on disposition of assets, net | 9,414 | 11,442 | 8,314 |
| Restructuring and asset writedowns | 104,686 | -- | -- |
| Cumulative effect of accounting change, net | -- | -- | 3,441 |
| Changes in operating assets and liabilities: | | | |
| Increase in trade and other receivables | (178,947) | (37,601) | (1,580) |
| (Increase) decrease in inventories | (33,933) | (13,862) | 5,908 |
| Decrease (increase) in receivables from OXY Receivables Corporation | 172,147 | (13,175) | (29,815) |
| Increase (decrease) in foreign income taxes payable | 279 | (406) | (167) |
| Increase in prepaid expenses | (7,338) | (258) | (581) |
| (Decrease) increase in accounts payable, accrued liabilities and property taxes | (94) | 37,871 | 23,777 |
| Increase in receivable from Occidental Chemical Corporation, net | -- | -- | (38,360) |
| (Decrease) increase in payable to Occidental Chemical Corporation, net | (4,110) | 13,349 | 38,528 |
| (Decrease) increase in payable to PolyOne Corporation, net | (28,995) | 91 | 622 |
| Other operating, net | (9,830) | (5,504) | 1,629 |
| Net cash provided by operating activities | 317,858 | 353,012 | 211,963 |
| CASH FLOW FROM INVESTING ACTIVITIES: | | | |
| Capital expenditures | (87,786) | (90,767) | (75,858) |
| Buy out of leased LaPorte facility and related railcars | -- | -- | (179,600) |
| Net cash used by investing activities | (87,786) | (90,767) | (255,458) |
| CASH FLOW FROM FINANCING ACTIVITIES: | | | |
| Payments of long term-debt | -- | -- | (105,000) |
| Distributions to partners | (112,500) | (188,283) | (80,000) |
| (Decrease) increase in loan payable to Occidental Petroleum Corporation | (116,634) | (74,056) | 224,111 |
| Net cash (used) provided by financing activities | (229,134) | (262,339) | 39,111 |
| Increase (decrease) in cash and cash equivalents | 938 | (94) | (4,384) |
| Cash and cash equivalents, beginning of year | 25 | 119 | 4,503 |
| Cash and cash equivalents, end of year | $ 963 | $ 25 | $ 119 |

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

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 2005 and 2004

## (1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES -

### Formation and operations -

Oxy Vinyls, LP ("OxyVinyls" or the "Partnership"), a Delaware limited partnership, was formed on April 6, 1999, pursuant to a Limited Partnership Agreement among Occidental PVC LP, Inc. (the "Oxy Limited Partner") and Occidental PVC, LLC (the "Oxy General Partner"), wholly-owned subsidiaries of Occidental Chemical Corporation ("OCC") and 1999 PVC Partner Inc., (the "PolyOne Limited Partner"), a subsidiary of PolyOne Corporation ("PolyOne"). The contributions and related transactions described in this Note were effective, and the Partnership commenced operations, as of April 30, 1999, at which time the Limited Partnership Agreement was amended pursuant to a First Amended and Restated Limited Partnership Agreement dated as of April 30, 1999 (collectively with the Limited Partnership Agreement, the "Partnership Agreement"). Through the Oxy General Partner and the Oxy Limited Partner, OCC indirectly owns a 76 percent interest in the Partnership. OCC is an indirect, wholly-owned subsidiary of Occidental Petroleum Corporation ("OPC"). Through the PolyOne Limited Partner, PolyOne indirectly owns a 24 percent interest in the Partnership.

The Partnership owns and operates polyvinyl chloride ("PVC"), vinyl chloride monomer ("VCM") and chlor-alkali manufacturing facilities in the United States and Canada that were contributed on behalf of the Oxy General Partner and the Oxy Limited Partner by OCC, and on behalf of the PolyOne Limited Partner, by PolyOne. A 50 percent equity interest in OXYMAR ("OxyMar"), which was a Texas general partnership between Oxy VCM Corporation ("Oxy VCM"), an indirect wholly-owned subsidiary of OPC, and U.S. VCM Corporation ("U.S. VCM"), a wholly-owned subsidiary of Marubeni Corporation ("Marubeni"), a Japanese corporation, was contributed to the Partnership at formation through the merger of Oxy VCM into the Oxy General Partner and the subsequent transfer by the Oxy General Partner of its equity interest in OxyMar to the Partnership. Effective April 1, 2003, OxyVinyls consolidated OxyMar under the provisions of Financial Accounting Standards Board ("FASB") Interpretation ("FIN") No. 46, "Consolidation of Variable Interest Entities" ("FIN No. 46"). (See Principles of consolidation and minority interest section below and Notes 2 and 3.) As of April 30, 2004, Marubeni exercised its option to put its interest in OxyMar to OCC. (See Note 2.)

Under terms of the Partnership Agreement, net income is allocated pro-rata among the partners based on their percentage ownership of the Partnership. Distributions to the partners and any additional cash contributions required by the Partnership are also based on the partners' percentage ownership of the Partnership.

### Principles of consolidation and minority interest -

The consolidated financial statements include the accounts of OxyVinyls, OxyMar (as discussed below), LaPorte Chemicals Corporation ("LaPorte"), OxyVinyls Export Sales LLC and OxyVinyls Canada Inc. ("OxyVinyls Canada"), whose functional currency is the U.S. dollar. All intercompany accounts and transactions have been eliminated.

Before April 30, 2004, OxyMar was 21.4 percent owned by U.S. VCM, 50 percent owned by OxyVinyls, and 28.6 percent owned and operated by OCC. On April 30, 2004 when Marubeni exercised its option to put its remaining interest in OxyMar to OCC, OxyMar became 50 percent owned by OxyVinyls and 50 percent owned and operated by OCC. The consolidated financial statements include 100 percent of the accounts of OxyMar effective April 1, 2003. U.S. VCM's 21.4 percent and OCC's 28.6 percent interest in OxyMar and OxyMar's results of operations from April 1, 2003 through April 30, 2004 have been reflected as minority interest. Subsequent to April 30, 2004, OCC's 50 percent interest in OxyMar and OxyMar's results of operations have been reflected as minority interest. (See Note 2.)

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - (continued)

Risks and uncertainties -

The process of preparing consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires the use of estimates and assumptions regarding certain types of assets, liabilities, revenues and expenses. Such estimates primarily relate to unsettled transactions and events as of the date of the consolidated financial statements. Accordingly, upon settlement, actual results may differ from estimated amounts, generally not by material amounts. Management believes that these estimates and assumptions provide a reasonable basis for the fair presentation of OxyVinyls' financial position and results of operations.

The carrying value of OxyVinyls' property, plant and equipment ("PP&E") is based on the cost incurred to acquire the PP&E, net of accumulated depreciation and any impairment charges. OxyVinyls performs impairment tests on its assets whenever events or changes in circumstances lead to a reduction in the estimated useful lives or estimated future cash flows that would indicate that the carrying amount may not be recoverable, or when management's plans change with respect to those assets. Under the provisions of Statement of Financial Accounting Standards ("SFAS") No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets" ("SFAS No. 144"), OxyVinyls must compare the undiscounted future cash flows of an asset to its carrying value. (See Note 6.)

Since OxyVinyls' major products are commodities, significant changes in the prices of chemical products could have a significant impact on OxyVinyls' results of operations for any particular period. OxyVinyls also depends on feedstocks and energy to produce chemicals, both of which are commodities subject to significant price fluctuations. OxyVinyls had two major customers during the periods presented, which accounted for 28.0 percent, 23.8 percent and 19.1 percent of total sales for the years ended December 31, 2005, 2004 and 2003, respectively. OxyVinyls' receivable from these two customers was approximately $77 million and $46 million at December 31, 2005 and 2004, respectively.

Substantially all key raw materials are supplied by related parties. (See Note 14.)

Revenue recognition -

Revenue from product sales is recognized after the product is shipped and title has passed to the customer. Prices are fixed at the time of shipment. Customer incentive programs provide for payments or credits to be made to customers based on the volume of product purchased over a defined period. Total customer incentive payments over a given period are estimated and recorded as a reduction to revenue ratably over the contract period. Such estimates are evaluated and revised as warranted.

Income taxes -

The Partnership is generally not subject to income taxes except for Canadian income taxes related to its consolidated subsidiary, OxyVinyls Canada, as well as certain U.S. state and federal income taxes associated with OxyVinyls' wholly-owned subsidiary, LaPorte.

The Partnership follows SFAS No. 109, "Accounting for Income Taxes", pursuant to which the liability method is used in accounting for taxes. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax basis of assets and liabilities, and are measured using the enacted tax rates and regulations that will be in effect when the differences are expected to reverse.

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - (continued)

Foreign currency transactions -

The functional currency applicable to OxyVinyls' Canadian operations is the U.S. dollar since cash transactions are principally denominated in U.S. dollars. The effect of exchange rate changes on transactions denominated in nonfunctional currencies generated a loss of $.3 million for the year ended December 31, 2005, a loss of $.7 million for the year ended December 31, 2004 and a loss of $.4 million for the year ended December 31, 2003. These amounts are included in the expense category of the item that gave rise to the related transaction gain or loss.

Cash and cash equivalents -

Cash equivalents consisted of highly liquid certificates of deposits with initial maturities of three months or less. (See Note 8.)

Interest income on deposits with unrelated parties was $.1 million in the year ended December 31, 2005 and $.3 million in the year ended December 31, 2004.

Cash overdrafts are reclassified to accounts payable and amounted to $7.1 million and $8.8 million as of December 31, 2005 and 2004, respectively.

Other assets, net -

Other assets, net also includes certain tangible assets and deferred charges that are amortized over the estimated periods to be benefited (three to ten years).

Major maintenance expenditures -

OxyVinyls uses the accrue-in-advance method to account for major maintenance turnaround expenditures. Under this method, an estimate is made of the costs expected to be incurred in connection with the next planned major maintenance shutdown. That estimate is then accrued on a straight-line basis over the period of time until the next planned major maintenance shutdown occurs. The liability for major maintenance turnaround expenditures included in accrued liabilities was $19.9 million and $21.3 million as of December 31, 2005 and 2004, respectively.

Asset retirement obligations -

In accordance with SFAS No. 143, "Accounting for Asset Retirement Obligations" ("SFAS No. 143"), OxyVinyls recognizes the fair value of a liability for an asset retirement obligation in the period in which the liability is incurred or becomes reasonably estimable and if there is a legal obligation to dismantle the asset and reclaim or remediate the property at the end of its useful life. The liability amounts are based on future retirement cost estimates and incorporate many assumptions such as time to abandonment, future inflation rates and the adjusted risk free rate of interest. When the liability is initially recorded, OxyVinyls capitalizes the cost by increasing the related property, plant and equipment balances. Over time the liability is increased and expense is recognized for the change in its present value, and the initial capitalized cost is depreciated over the useful life of the asset. No market risk premium has been included in OxyVinyls' liability since no reliable estimate can be made at this time. (See Note 3.)

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - (continued)

Asset retirement obligations - (continued)

The following table summarizes the activity of the asset retirement obligation for the years ended December 31, (in thousands):

| | 2005 | 2004 |
|---|---|---|
| Beginning balance | $13,316 | $ 8,517 |
| Accretion expense | 926 | 871 |
| Revisions to estimated cash flows | 211 | 3,928 |
| Ending Balance | $14,453 | $13,316 |

Exchanges -

Finished product exchange transactions, which involve homogeneous commodities held for sale in the ordinary course in the same line of business and do not involve the payment or receipt of cash, are not accounted for as purchases and sales. Any resulting volumetric exchange balances are accounted for as inventory in accordance with established inventory valuation policy.

Research and development costs -

Research and development costs, which are charged to selling, general and administrative and other operating expenses as incurred, were $3.0 million, $3.4 million and $3.1 million for the years ended December 31, 2005, 2004 and 2003, respectively.

Supplemental cash flow information -

Cash payments for income taxes totaled $2.8 million, $2.2 million and $2.8 million during the years ended December 31, 2005, 2004 and 2003, respectively. Net interest paid totaled $12.8 million, $13.1 million and $6.9 million during the years ended December 31, 2005, 2004 and 2003, respectively.

During the year ended December 31, 2004, OxyVinyls sold trade receivables to an affiliate, OXY Receivables Corporation ("ORC"). (See Note 4.)

Fair value of financial instruments -

OxyVinyls values financial instruments as required by SFAS No. 107, "Disclosures about Fair Value of Financial Instruments". The carrying amounts of cash and cash equivalents approximate fair value because of the short maturity of those instruments. OxyVinyls estimates the fair value of its long-term debt based on the quoted market prices for the same or similar issues or on the yields offered to OxyVinyls for debt of similar rating and similar remaining maturities. The estimated fair value of OxyVinyls' note payable to OCC was approximately $10.0 million and $10.2 million at December 31, 2005 and 2004, respectively, compared with a carrying value of $10.0 million at each of December 31, 2005 and 2004. (See Note 7.) The estimated fair value of OxyMar's bonds referenced in Note 7 was $193.2 million and $200.4 million at December 31, 2005 and 2004, respectively, compared with a carrying value of $164.6 million at each of December 31, 2005 and 2004. The carrying value of all other financial instruments approximates fair value.

(2) OXYMAR -

OxyMar is a partnership that is 50 percent owned by OxyVinyls and 50 percent owned by Oxy VCM, LP, an indirectly wholly-owned subsidiary of OCC. OxyMar owns a VCM manufacturing facility at Ingleside, Texas, which is operated on OxyMar's behalf by OCC pursuant to an operating agreement. OxyMar is not subject to federal or state income taxes because its income is directly reportable by the individual partners. OxyVinyls accounted for its investment in OxyMar using the equity method of accounting until April 1, 2003 when OxyMar was consolidated under FIN No. 46. (See Consolidation of OxyMar below.)

Equity investment -

In 2000, U.S. VCM transferred 28.6 percent of its ownership of OxyMar to Oxy VCM, LP. In connection with this transfer, OxyVinyls, Oxy VCM, LP and U.S. VCM entered into the Second Amended and Restated Partnership Agreement ("OxyMar Partnership Agreement") which pertains to the ownership and operation of OxyMar. Pursuant to the OxyMar Partnership Agreement, U.S. VCM and OxyVinyls retained 50/50 management control of OxyMar.

On April 30, 2004, Marubeni exercised its option to transfer its remaining 21.4 percent interest in OxyMar by paying $19.5 million to OCC. In connection with the transfer, OPC accepted the assignment of Marubeni's guarantee of OxyMar's debt. Because all the OxyMar debt was already consolidated in OxyVinyls' financial statements with the adoption of the FIN No. 46, the exercise of the option did not have a material effect on OxyVinyls' financial position or results of operations.

The percentage ownership interest held by each partner of OxyMar is:

| From November 29, 2000 through April 30, 2004 | | Subsequent to April 30, 2004 | |
|---|---|---|---|
| OxyVinyls | 50.0 percent | OxyVinyls | 50.0 percent |
| Oxy VCM, LP | 28.6 percent | Oxy VCM, LP | 50.0 percent |
| U.S. VCM | 21.4 percent | U.S. VCM | -- |

Under the terms of the Third Amended and Restated Partnership Agreement effective April 30, 2004, net income is allocated among the partners pro-rata based on their percentage interest in the results of OxyMar. Distributions to the partners are also based on the partners' percentage interest in OxyMar.

(2) OXYMAR - (continued)

Equity investment - (continued)

At March 31, 2003, the historical underlying equity in net assets of OxyMar exceeded the Partnership's investment in OxyMar by $6.3 million. The deficiency was being amortized on a straight-line basis into income over 25 years. Amortization was $.1 million for the period ended March 31, 2003 and is included in equity in (losses)/earnings of unconsolidated subsidiary on the consolidated statements of operations. Upon the consolidation of OxyMar on April 1, 2003, this deficiency was treated as an adjustment to property, plant and equipment. The following table presents summarized financial information of OxyMar for the three months ended March 31, 2003 and as of March 31, 2003, (in thousands):

| | |
|---|---|
| Net sales | $138,684 |
| Costs and expenses | 146,031 |
| Net loss | $ (7,347) |
| Current assets | $ 71,635 |
| Noncurrent assets | $315,774 |
| Current liabilities | $ 53,046 |
| Noncurrent liabilities | $388,468 |
| Partners' capital deficit | $(54,105) |

Consolidation of OxyMar -

In January 2003, the FASB issued FIN No. 46, "Consolidation of Variable Interest Entities" ("FIN No. 46"), which requires a company to consolidate a variable interest entity ("VIE") if it is designated as the primary beneficiary of that entity even if the company does not have a majority of the VIE's voting interests. A VIE is generally defined as an entity whose equity is unable to finance its activities or whose owners lack the risks and rewards of ownership. The statement also imposes disclosure requirements for all the VIEs of a company, even if the company is not the primary beneficiary. The provisions of this statement apply at inception for any entity created after January 31, 2003. OxyVinyls adopted the provisions of FIN No. 46 for its existing entities on April 1, 2003, which resulted in the consolidation of its OxyMar investment. As a result of the OxyMar consolidation, assets increased by approximately $373 million, liabilities increased by approximately $399 million and minority interest of a negative $27 million was recorded. There was no material effect on net income as a result of the consolidation.

See Note 14 regarding OxyVinyls' purchase commitment from OxyMar. Unrealized profits on inventory purchased from OxyMar prior to the consolidation of OxyMar were deferred by OxyVinyls based on its ownership percentage and were recognized upon the ultimate sale to an unaffiliated customer. All intercompany accounts and transactions between OxyVinyls and OxyMar have been eliminated.

(3) ACCOUNTING CHANGES -

Future accounting change -

In September 2005, the Emerging Issues Task Force ("EITF") finalized the provisions of EITF Issue No. 04-13, "Accounting for Purchases and Sales of Inventory with the Same Counterparty" ("EITF No. 04-13"), which provides accounting guidance about whether buy/sell arrangements should be accounted for at historical cost and whether these arrangements should be reported on a gross or net basis. Buy/sell arrangements typically are contractual arrangements where the buy and sell agreements are entered into in contemplation of one another with the same counterparty. OxyVinyls reports all buy/sell arrangements on a net basis, at historical cost. This EITF is effective in the first interim period beginning after March 15, 2006, and OxyVinyls will prospectively adopt this statement in the second quarter of 2006. OxyVinyls is currently assessing the effect of EITF No. 04-13, but does not expect it to have a material effect on its financial statements.

Recently adopted accounting changes -

Certain OxyVinyls executives participate in OPC stock-based incentive plans that are described in Note 11. On July 1, 2005, OPC early adopted the fair value recognition provisions of SFAS No. 123R, "Share-Based Payments" ("SFAS No. 123R"), under the modified prospective transition method. Prior to July 1, 2005, OPC applied the Accounting Principles Board (APB) Opinion No. 25 intrinsic value accounting method for its stock incentive plans. Under the modified prospective transition method, the fair value recognition provisions apply only to new awards or awards modified after July 1, 2005. Additionally, the fair value of existing unvested awards at the date of adoption is recorded in compensation expense over the remaining requisite service period. OPC adopted this statement in the third quarter of 2005 and the adoption did not have a material impact on the consolidated financial statements of OxyVinyls. (See Note 11.)

In March 2005, the FASB issued FIN No. 47, "Accounting for Conditional Asset Retirement Obligations" ("FIN No. 47"). FIN No. 47 specifies the accounting treatment for conditional asset retirement obligations under the provisions of SFAS No. 143. FIN No. 47 is effective no later than the end of fiscal years ending after December 15, 2005. OxyVinyls has identified conditional asset retirement obligations at a certain number of its facilities that are mainly related to plant decommissioning. Under FIN No. 47, which OxyVinyls adopted on December 31, 2005, OxyVinyls is required to record the fair value of these conditional liabilities if they can be reasonably estimated. However, OxyVinyls believes that there is an indeterminate settlement date for these asset retirement obligations because the range of time over which OxyVinyls may settle these obligations is unknown or cannot be estimated. Therefore, OxyVinyls cannot reasonably estimate the fair value of these liabilities. OxyVinyls will recognize these conditional asset retirement obligations in the period in which sufficient information becomes available to reasonably estimate their fair values.

In November 2004, the FASB issued SFAS No. 151, "Inventory Costs, an amendment of FASB Accounting Research Bulletin No. 43, Chapter 4" ("SFAS No. 151"). SFAS No. 151 clarifies the accounting treatment for various inventory costs and overhead allocations. SFAS No. 151 is effective for inventory costs incurred after July 1, 2005. OxyVinyls adopted this statement in the third quarter of 2005 and it did not have a material effect on the financial statements when adopted.

In May 2004, the FASB issued FSP ("FASB Staff Positions") No. 106-2, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003" ("FSP No. 106-2"), which specifies the accounting and disclosure requirements for the prescription drug benefits that are available under this new plan. OxyVinyls adopted the disclosure provisions of this pronouncement in the second quarter of 2004. (See Note 12.)

(3) ACCOUNTING CHANGES - (continued)

Recently adopted accounting changes - (continued)

In December 2003, the FASB revised FIN No. 46 to exempt certain entities from its requirements and to clarify certain issues arising during the initial implementation of FIN No. 46. OxyVinyls adopted the revised interpretation in the first quarter of 2004 and it did not have a material impact on the financial statements when adopted. (See Note 2.)

Effective January 1, 2003, OxyVinyls adopted SFAS No. 143, "Accounting for Asset Retirement Obligations" ("SFAS No. 143"). SFAS No. 143 addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. OxyVinyls makes capital renewal expenditures for its chemical plants on a continual basis while an asset is in operation. Thus, retirement obligations are provided for when a decision is made to dispose of a property or when operations have been curtailed on other than a temporary basis. Under SFAS No. 143, companies are required to recognize the fair value of a liability for an asset retirement obligation in the period in which the liability is incurred if there is a legal obligation to dismantle the asset and reclaim or remediate the property at the end of the useful life. The initial adoption resulted in an after-tax charge of $3.4 million, which was recorded as a cumulative effect of a change in accounting principles. The adoption increased net property, plant and equipment by $3.6 million, increased asset retirement obligations by $7.2 million and decreased deferred foreign tax liabilities by $.4 million.

(4) TRADE RECEIVABLES -

During the first quarter of 2005 and the year ended December 31, 2004, OxyVinyls sold trade receivables originated by it to ORC under a revolving sale program in connection with the sale of an undivided ownership interest in such receivables by ORC. Receivables sold did not include OxyVinyls' export sales or any OxyMar receivables. OxyVinyls served as the collection agent with respect to the receivables sold. An interest in new receivables was sold monthly in noncash transactions representing the net difference between newly created receivables and collections made from customers. The net receivables balance sold was $172 million as of December 31, 2004. OxyVinyls discontinued the sale of its receivables to ORC on April 1, 2005.

(5) INVENTORIES -

Inventories are valued at the lower of cost or market. The last-in, first-out ("LIFO") method was used to determine the cost of $66 million and $75 million of OxyVinyls' U.S. inventories at December 31, 2005 and 2004, respectively. The remaining inventories in Canada and OxyMar are accounted for using the first-in, first-out ("FIFO") and weighted-average-cost methods. Inventories consisted of the following at December 31, (in thousands):

| | 2005 | 2004 |
|---|---|---|
| Raw materials | $ 41,732 | $ 32,744 |
| Materials and supplies | 17,129 | 18,550 |
| Finished goods | 182,322 | 113,861 |
| | 241,183 | 165,155 |
| LIFO and lower of cost or market reserve | (74,462) | (31,215) |
| Total inventories | $166,721 | $133,940 |

(5) INVENTORIES - (continued)

In 2005 there was a liquidation of LIFO inventory quantities carried at different costs in prior years as compared with the cost of 2005 purchases, the effect of which decreased cost of sales by approximately $7.6 million. During 2004, inventory quantities carried at LIFO increased.

(6) PROPERTY, PLANT AND EQUIPMENT -

Property additions and major renewals and improvements are capitalized at cost. Capitalized interest costs incurred in connection with major capital expenditures are capitalized and depreciated over the lives of the related assets. OxyVinyls capitalized $4.2 million and $1.0 million of interest during the years ended December 31, 2005 and 2004, respectively.

The estimated useful lives of OxyVinyls' assets, which range from three years to 50 years, are used to compute depreciation expense and are also used in impairment tests. The estimated useful lives used for the facilities are based on the assumption that OxyVinyls will provide an appropriate level of annual expenditures to ensure that productive capacity is maintained. Without these continued expenditures, the useful lives of these plants could significantly decrease. Other factors which could change the estimated useful lives of OxyVinyls' plants include sustained higher or lower product prices, which are particularly affected by both domestic and foreign competition, feedstock costs, energy prices, environmental regulations, competition and technological changes.

OxyVinyls is required to perform impairment tests on its assets whenever events or changes in circumstances lead to a reduction in the estimated useful lives or estimated future cash flows that would indicate that its carrying amount may not be recoverable, or when management's plans change with respect to those assets. Under the provisions of SFAS No. 144, OxyVinyls must compare the undiscounted future cash flows of an asset to its carrying value. The key factors which could significantly affect future cash flows are future product prices, which are particularly affected by both domestic and foreign competition, feedstock costs, energy costs, significantly increased regulation and remaining estimated useful life.

Due to a temporary decrease in demand for some of its products, OxyVinyls temporarily idled a chlor-alkali plant in December 2001. During the third quarter of 2005, OxyVinyls reviewed all of its assets and decided to close its least competitive plants and upgrade certain remaining operations. As a result of this review, OxyVinyls recorded a $92.5 million charge for the write-off of the previously idled chlor-alkali facility. (See Note 15.)

OxyMar receives steam from an adjacent cogeneration facility through an affiliate of OCC. OxyMar had maintained steam boilers as a backup source of steam in the event that the cogeneration facility was unable to provide steam for VCM facility. Management determined that it was no longer necessary to maintain the boilers in a stand-by condition as a backup source of steam due to the proven reliability of the cogeneration facility. The remaining net book value of the steam boilers, $3.0 million, was written off in the third quarter of 2005.

On December 2, 2005, OxyVinyls formally announced that the OxyVinyls PVC plant in Scotford, Alberta would close at the end of January 2006. At December 31, 2005, the remaining net book value of the Scotford plant is $.3 million. As such, no impairment write-down is considered necessary in accordance with SFAS No. 144 since the plant's remaining net book value as of December 31, 2005 is recoverable.

OxyVinyls' plants are depreciated using either the unit-of-production or straight-line method based upon the estimated useful life of the facilities.

(6) PROPERTY, PLANT AND EQUIPMENT - (continued)

Property, plant and equipment consisted of the following at December 31, (in thousands):

| | 2005 | 2004 |
|---|---|---|
| Land and land improvements | $ 48,806 | $ 46,376 |
| Buildings | 71,430 | 68,476 |
| Machinery and equipment | 2,032,851 | 2,077,196 |
| Construction in progress | 70,164 | 55,988 |
| | 2,223,251 | 2,248,036 |
| Accumulated depreciation | (999,950) | (894,113) |
| Property, plant and equipment, net | $1,223,301 | $1,353,923 |

(7) LONG-TERM DEBT AND NOTE PAYABLE TO OCCIDENTAL CHEMICAL CORPORATION -

A note payable to OCC of $10.0 million has an interest rate of 4.2 percent. The note is due November 1, 2006, and is reflected in current liabilities in the accompanying consolidated balance sheets as of December 31, 2005. Interest expense related to the note payable to OCC was $.4 million for the each of the years ended December 31, 2005, 2004 and 2003.

OxyMar issued bonds with an aggregate principal amount of $165 million which bear interest at 7.5 percent per year and are due in 2016 (the "Bonds"). Proceeds, net of amortizable financing fees and original issue discount, totaled $163.3 million. Semi-annual interest payments are due on February 15 and August 15. OxyMar is obligated to make semi-annual principal repayments of a minimum of $8.3 million beginning August 15, 2006. OPC unconditionally guarantees OxyMar's obligation to pay interest and principal on the Bonds. OPC has purchased $108.7 million of the Bonds as of December 31, 2005. The current portion of the bond obligation, $8.3 million, is reflected in current liabilities and the remaining bond obligation of $156.8 million, net of unamortized bond discounts of $.4 million, is reflected in long-term debt. Interest expense related to the Bonds was $12.4 million for each of the years ended December 31, 2005, 2004 and 2003.

Future minimum principal payments on the Bonds are as follows (in thousands):

| | |
|---|---|
| 2006........ | $ 8,250 |
| 2007........ | 16,500 |
| 2008 ....... | 16,500 |
| 2009........ | 16,500 |
| 2010........ | 16,500 |
| Thereafter.. | 90,750 |
| | $165,000 |

OxyMar had a $220 million revolving credit facility agreement with a consortium of banks. In June 2003, OxyMar repaid the outstanding balance of $105 million with the proceeds from the revolving loan agreement with OPC (the "OPC Revolver"). (See Note 8.) The revolving credit facility agreement was terminated on December 29, 2003.

(8) CASH MANAGEMENT AND CREDIT AND DEPOSIT FACILITIES AGREEMENTS WITH OPC -

OxyVinyls participates in OPC's centralized cash management system for its domestic operations through OPC's affiliate, Occidental Petroleum Investment Co., and maintains a concentration account to collect cash receipts and fund disbursements. OPC funds any negative cash balances and collects any excess cash balances on a daily basis in the concentration account under the terms of a Cash Management and Credit and Deposit Facilities Agreement between OPC and OxyVinyls (the "Agreement").

Under the terms of the Agreement, OPC committed to loan OxyVinyls, on a revolving basis, up to $104 million. PolyOne guaranteed $42.3 million of the OxyVinyls' loans payable to OPC. PolyOne's guaranty was terminated on June 30, 2003 when OxyVinyls reached an agreed amount of cumulative earnings before income taxes, depreciation and amortization. A new Cash Management and Credit and Deposit Facilities Agreement (the "New Agreement"), replaced the original Agreement as of July 1, 2003. An amendment to the New Agreement extended the termination date to May 1, 2006. As of December 31, 2005, the balance of loans payable to OPC was $5.8 million, which, including interest, has been combined and recorded as loans payable to OPC, net in the accompanying consolidated balance sheets. As of December 31, 2004, the balance of loans receivable from OPC was $28.7 million, which, including interest, has been netted against other loan payable amounts and recorded as loans payable to OPC, net. OPC will not require repayment of the $5.8 million in aggregate principal amount due from OxyVinyls under the New Agreement prior to January 1, 2007.

Through June 30, 2003, loans payable to OPC accrued interest at the one-month London Interbank Offered Rate ("LIBOR") plus a calculated variable margin. Loans receivable from OPC accrued interest at the one-month LIBOR. From July 1, 2003 through April 25, 2004, the margin was 350 basis points. The first amendment to the New Agreement increased the margin to 500 basis points. Net interest income was $(.8) million and $(1.2) million for the years ended December 31, 2005 and 2004, respectively. There was minimal net interest income for the year ended December 31, 2003. There were no fees payable to OPC under the Agreement for the years ended December 31, 2005 and 2004. Fees payable to OPC under the Agreement totaled $.3 million for the year ended December 31, 2003. These fees are included in other operating expenses.

In June 2002, OPC provided an additional loan of $13.7 million under an amendment to the Agreement with repayment required upon the earliest of the Deer Park, Texas chlor-alkali plant restart, termination of the credit facility or December 31, 2006. This loan bears interest consistent with the terms of the New Agreement. At December 31, 2005, the outstanding loan balance of $13.7 million was reflected in current liabilities, while at December 31, 2004, the outstanding loan balance was included in the loans payable to OPC, net. Interest expense was $1.2 million, $.8 million and $.5 million for the years ended December 31, 2005, 2004 and 2003, respectively.

In April 2003, OPC provided a loan of $179.6 million under the Term Loan Agreement (the "Term Loan") to fund the purchase of the leased LaPorte VCM plant. Under terms of the New Agreement, mandatory prepayment of outstanding debt is required when distributable cash is available, at an amount equal to 25 percent of distributable cash. OxyVinyls prepaid $46.9 million during 2004 and $37.5 million during 2005, which reduced the Term Loan balance to $95.2 million. At December 31, 2005, the outstanding loan balance of $95.2 million was included in loans payable to OPC, net. An amendment to the Term Loan extended the due date to May 1, 2006. OPC will not require repayment of the $95.2 million in aggregate principal amount due from OxyVinyls under the Term Loan prior to January 1, 2007. This loan accrues interest at the one-month LIBOR plus a calculated variable margin. From April 2003 through April 2004, the margin was 350 basis points. The amendment to the Term Loan increased the margin to 500 basis points. Interest expense was $10.2 million, $10.3 million and $5.8 million for the years ended December 31, 2005, 2004 and 2003, respectively.

(8) CASH MANAGEMENT AND CREDIT AND DEPOSIT FACILITIES AGREEMENTS WITH OPC - (continued)

The New Agreement and Term Loan may be terminated by either OxyVinyls or OPC, at which date any outstanding loans and any accrued interest and fees payable become due.

Under the OPC Revolver with OxyMar, OPC will make loans each business day in an amount equal to the funds required to eliminate any negative balance in OxyMar's bank account plus any payments due to OPC. In addition, OxyMar shall transfer any excess funds at the end of each business day from its bank account to OPC. The credit facility limit was $225 million at December 31, 2005. The termination date of the OPC Revolver is May 1, 2006. OPC will not require the repayment of the $19.2 million in aggregate principal amount due from OxyMar under the OPC Revolver prior to January 1, 2007. The outstanding loan from OPC of $19.2 million at December 31, 2005 was included in loans payable to OPC, net. Interest is calculated at the Eurodollar rate plus the applicable credit facility margin, which was increased to 500 basis points in an amendment to the OPC Revolver. Interest expense on the OPC Revolver was $7.4 million and $8.6 million for the years ended December 31, 2005 and 2004, respectively. Interest expense was $2.5 million for the period from April 1, 2003 through December 31, 2003.

(9) ENVIRONMENTAL LIABILITIES -

OxyVinyls is engaged in voluntary discussions with federal, state and local environmental agencies with jurisdiction over four of its manufacturing facilities in an effort to reach an agreement to reduce VCM emissions and to resolve disputed administrative claims and allegations of past or ongoing environmental violations at those facilities, some of which claims allege penalties in excess of $.1 million. If any agreement to reduce the emissions and resolve the claims and allegations were reached, OxyVinyls believes it would require the payment of penalties, or the performance of supplemental environmental projects, exceeding a total cost of $.1 million. OxyVinyls does not expect the resolution of this matter to have a material effect on its financial condition or results of operations.

Pursuant to the terms of the asset contribution agreements with OxyVinyls, each partner is responsible for the environmental remediation costs and associated claims arising out of, in connection with or relating to conditions that existed prior to the formation of OxyVinyls with respect to the assets contributed by that partner. This responsibility extends to, among other things, environmental remediation of conditions identified before forming OxyVinyls and conditions first identified within ten years after the formation date, except to the extent, if any, that OxyVinyls exacerbates or accelerates the condition as provided in the contribution agreements. OxyVinyls has not created environmental conditions that currently require ongoing remediation pursuant to applicable laws, and has not exacerbated or accelerated any such environmental conditions. Since May 1, 1999, OxyVinyls has manufactured, processed, handled, used, reused, recycled, treated, stored and/or disposed of materials at or from its facilities in the ordinary course of its business. The possibility that the actions of OxyVinyls may require future remediation at any particular site is currently considered remote. Since OxyVinyls itself has no environmental remediation responsibilities that are probable and can be reasonably estimated, no accrual by OxyVinyls for environmental remediation is warranted.

## (10) COMMITMENTS AND CONTINGENCIES -

### Leases -

At December 31, 2005, future net minimum rental commitments under noncancelable operating leases with terms in excess of one year are as follows (in thousands):

| | |
|---|---|
| 2006 | $16,649 |
| 2007 | 14,025 |
| 2008 | 13,651 |
| 2009 | 11,228 |
| 2010 | 8,844 |
| Thereafter | 15,559 |
| | $79,956 |

OxyVinyls leased certain VCM manufacturing facilities in LaPorte, Texas, and railcars under the terms of various related agreements dated April 30, 1999 (collectively, the "LaPorte Lease"). In April 2003, OxyVinyls purchased the assets of the LaPorte Lease for their estimated fair value of approximately $180 million and purchased certain leased railcars for $20.3 million.

OxyVinyls has commitments for guaranteed residual values on leased equipment that totaled approximately $6.7 million as of December 31, 2005.

Rent expense was approximately $19.1 million, $19.2 million and $21.3 million for the years ended December 31, 2005, 2004 and 2003, respectively, and is included in cost of sales in the consolidated statements of operations.

### Other -

OxyVinyls has certain other contractual commitments to purchase electrical power, raw materials and other obligations, all in the ordinary course of business and at market prices.

The Partnership also becomes involved in certain legal proceedings in the normal course of business. Management believes that the outcome of such matters will not significantly affect the Partnership's consolidated financial position or results of operations.

Also see Notes 1 and 13 related to income taxes and Notes 7, 8 and 14 regarding related parties.

## (11) STOCK-BASED INCENTIVE PLANS -

Certain OxyVinyls executives and senior managers participate in several OPC plans that provide for stock-based awards in the form of options, restricted stock ("RSUs"), stock bonuses, stock appreciation rights ("SARs") and performance stock awards ("PSAs").

(11) STOCK-BASED INCENTIVE PLANS - (continued)

As discussed in Note 3, on July 1, 2005, OPC changed its method of accounting for stock-based compensation from the APB Opinion No. 25 intrinsic value accounting method to the fair value recognition provisions of SFAS No. 123R. Prior to July 1, 2005, OxyVinyls had already been expensing its SARs, RSUs and PSAs charges from OPC. On July 1, 2005, OxyVinyls began expensing its OPC options and recording compensation expense for all other OPC stock-based incentive awards using fair value amounts in accordance with SFAS No. 123R. OPC estimates the fair values of options and stock settled SARs using the Black-Scholes option valuation model and estimates the fair values of stock settled PSAs using a Monte Carlo simulation model. The adoption of SFAS No. 123R did not have a material impact on the consolidated financial statements of OxyVinyls.

OxyVinyls was charged by OPC and recognized compensation expenses for stock-based incentive plans of $4.8 million, $.6 million and $.7 million during the years ended December 31, 2005, 2004 and 2003, respectively. As of December 31, 2005, there was $5.3 million of unrecognized compensation expense related to all unvested stock-based incentive award grants. This expense is expected to be recognized over a weighted average period of 1.6 years.

The difference between compensation expense recorded by OxyVinyls using the intrinsic value method and the fair value method using SFAS No. 123R for the six months ended June 30, 2005 and the years ended December 31, 2004 and 2003 was not significant.

(12) RETIREMENT PLANS AND POSTRETIREMENT BENEFITS -

OxyVinyls participates in various defined contribution retirement plans that provide for periodic contributions by OxyVinyls based on plan-specific criteria, such as base pay, age level and/or employee contributions. Certain salaried employees participate in a supplemental retirement plan that provides restoration of benefits lost due to governmental limitations on qualified retirement benefits. The accrued liabilities for the supplemental retirement plan were $1.0 million and $.8 million as of December 31, 2005 and 2004, respectively, and OxyVinyls expensed approximately $6.3 million in both 2005 and 2004 and $7.2 million in 2003 under the provisions of these defined contribution and supplemental retirement plans.

OxyVinyls provides medical and dental benefits and life insurance coverage for certain active, retired and disabled employees and their eligible dependents. The benefits generally are funded by OxyVinyls as the benefits are paid during the year. The cost of providing these benefits is based on claims filed and insurance premiums paid for the period. The total benefit costs, including the postretirement costs, were approximately $9.0 million in 2005, $9.1 million in 2004, and $9.4 million in 2003.

On December 8, 2003, President Bush signed into law a bill that expands Medicare, primarily adding a prescription drug benefit for Medicare-eligible retirees starting in 2006. Regulations governing the Medical Prescription drug benefit and other key elements of the Medicare Modernization Act were released by the Department of Health and Human Services Centers for Medicare and Medicaid Services on January 21, 2005. OxyVinyls has determined that its retiree healthcare plans will qualify OxyVinyls for a federal subsidy available on benefits provided to plan participants which meet certain actuarial equivalence requirements. The $.5 million reduction in the Accumulated Postretirement Benefit Obligation due to the expected future subsidy has been treated as an actuarial experience gain which will be amortized to expense in future years through a decrease in the amortization of the unrecognized net loss, in accordance with FSP No. 106-2. The annual reduction in OxyVinyls' other postretirement benefits expense due to the subsidy is expected to be approximately $.1 million.

(12) RETIREMENT PLANS AND POSTRETIREMENT BENEFITS - (continued)

Obligations and Funded Status -

OxyVinyls uses a measurement date of December 31 for postretirement benefit plans.

| For years ended December 31, (in thousands) | 2005 | 2004 |
|---|---|---|
| Changes in benefit obligation: | | |
| Benefit obligation - beginning of year | $ 32,819 | $ 29,348 |
| Service cost - benefits earned during the period | 881 | 822 |
| Interest cost on projected benefit obligation | 1,792 | 1,729 |
| Actuarial loss | 1,531 | 2,099 |
| Benefits paid | (1,172) | (1,179) |
| Benefit obligation - end of year | $ 35,851 | $ 32,819 |
| Funded status: | | |
| Unfunded obligation | $(35,851) | $(32,819) |
| Unrecognized net loss | 11,229 | 10,373 |
| Net amount recognized | $(24,622) | $(22,446) |
| Accrued benefit liability | $(24,622) | $(22,446) |
| Net amount recognized | $(24,622) | $(22,446) |

Components of Net Periodic Benefit Cost -

| For the years ended December 31, (in thousands) | 2005 | 2004 |
|---|---|---|
| Net periodic benefit cost: | | |
| Service cost-benefits earned during the period | $ 881 | $ 822 |
| Interest cost on benefit obligation | 1,792 | 1,729 |
| Recognized actuarial loss | 675 | 590 |
| Net periodic benefit cost | $3,348 | $3,141 |

Additional information -

OxyVinyls' postretirement benefit plan obligations are determined based on various assumptions and discount rates, as described below. The actuarial assumptions used could change in the near term as a result of changes in expected future trends and other factors which, depending on the nature of the changes, could cause increases or decreases in the liabilities accrued.

The following table sets forth the discount rates used to determine OxyVinyls' benefit obligation and net periodic benefit cost for postretirement benefit plans:

| For the years ended December 31, | 2005 | 2004 |
|---|---|---|
| Discount rates: | | |
| Benefit obligation | 5.33% | 5.50% |
| Net period benefit cost | 5.50% | 6.00% |

(12) RETIREMENT PLANS AND POSTRETIREMENT BENEFITS - (continued)

The postretirement benefit obligation was determined by application of the terms of medical and dental benefits and life insurance coverage, including the effect of established maximums on covered costs, together with relevant actuarial assumptions and healthcare cost trend rates projected at a Consumer Price Index ("CPI") increase of three percent as of December 31, 2005 and 2004. Participants pay for all medical cost increases in excess of increases in the CPI. Consequently, increases in the assumed healthcare cost trend rates would have no impact on the postretirement benefit obligation at December 31, 2005 and 2004.

Estimated future benefit payments, which reflect expected future service, as appropriate, are expected to be paid as follows:

For the years ended December 31, (in thousands):

| | |
|---|---|
| 2006 | $ 1,400 |
| 2007 | 1,600 |
| 2008 | 1,800 |
| 2009 | 2,000 |
| 2010 | 2,200 |
| 2011-2015 | 13,500 |

In addition, postemployment and Canadian postretirement healthcare obligations were $4.8 million and $2.1 million at December 31, 2005 and 2004, respectively.

(13) INCOME TAXES -

Deferred foreign income taxes reflect the future tax consequences of temporary differences between the tax basis of assets and liabilities and their reported amounts. Deferred foreign income taxes were as follows:

For the years ended December 31, (in millions):

| Tax effects of temporary differences: | 2005 | 2004 |
|---|---|---|
| Net operating losses | $ 9.7 | $ 4.1 |
| PP&E differences | 4.1 | -- |
| All other differences | 3.6 | -- |
| Total deferred tax assets | $ 17.4 | $ 4.1 |
| PP&E differences | $ -- | $(2.1) |
| All other differences | -- | 1.1 |
| Total deferred tax liabilities | $ -- | $(1.1) |
| Valuation allowance | $(17.4) | $(3.0) |
| Total deferred taxes | $ -- | $ -- |

(13) INCOME TAXES - (continued)

At December 31, 2005 and 2004, OxyVinyls had Canadian federal and provincial net operating loss carryforwards of approximately $24.9 million and $12.0 million, respectively. The temporary differences resulting in deferred foreign income tax assets are primarily related to property, plant and equipment with the exception of $6.1 million recorded in 2005 related to the shutdown of the Scotford plant.

The current provision/(benefit) for income tax was $2.9 million, with no deferred provision/(benefit), for the year ended December 31, 2005; $1.9 million and $(3.1) million, respectively, for the year ended December 31, 2004; and $1.4 million and $.3 million, net of $(.5) million included in cumulative effect of accounting change, respectively, for the year ended December 31, 2003.

OxyVinyls is subject to audit by taxing authorities in various tax jurisdictions. Management believes that any resulting adjustments to OxyVinyls' tax liabilities would not have a material adverse impact on its financial position or results of operations.

(14) RELATED PARTY TRANSACTIONS -

OxyVinyls sells PVC to PolyOne under the terms of a sales agreement that expires on December 31, 2013. The agreement requires PolyOne and its majority affiliates to purchase their annual PVC requirements in North America in excess of 290 million pounds from OxyVinyls. For the first 880 million pounds of PVC supplied in any calendar year, PolyOne will pay a price based upon cost and other market considerations. PolyOne will purchase all volumes over 880 million pounds in any calendar year at a competitive market price.

OxyVinyls sells VCM to OCC and PolyOne under the terms of separate sales agreements that expire on December 31, 2013. The agreements require that OCC and PolyOne purchase all of their VCM requirements for production of PVC in North America from OxyVinyls at market price. Under the terms of the agreements, PolyOne and OCC receive an integration credit on the first 210 million and 215 million pounds purchased in any year, respectively, to compensate for surrendered purchasing power on major feedstocks. Additionally, under the terms of a new agreement entered into in 2005 that expires on December 31, 2007, OxyVinyls sells a limited quantity of VCM to OCC.

OxyVinyls' sales of VCM to OCC under the terms of these agreements were approximately $1.7 million, $54.6 million and $40.8 million for the years ended December 31, 2005, 2004 and 2003, respectively. OxyVinyls' sales of PVC and VCM to PolyOne under the terms of these agreements were approximately $368 million, $273 million and $227 million for the years ended December 31, 2005, 2004 and 2003, respectively.

OxyVinyls sells chlor-alkali and other specialty products to OCC under the terms of a sales agreement that expires on December 31, 2013. This agreement requires OCC to purchase at a market-related price all of these products produced by OxyVinyls that are not required for its internal uses. This agreement further requires OxyVinyls to pay OCC a fee for marketing excess chlor-alkali products to third parties. OxyVinyls sold $179.1 million, $107.5 million and $104.6 million of chlor-alkali and specialty products to OCC during the years ended December 31, 2005, 2004 and 2003, respectively. OxyVinyls paid a marketing fee of $13.0 million, $13.4 million and $13.8 million to OCC during the years ended December 31, 2005, 2004 and 2003, respectively.

(14) RELATED PARTY TRANSACTIONS - (continued)

OxyVinyls purchases ethylene from Equistar Chemicals LP ("Equistar"), an affiliate of Lyondell Chemical Corporation, an equity investee of OPC, under the terms of an agreement. The original agreement, in place from 2000 through 2003, required that OxyVinyls purchase ethylene at market price. During 2000, 250 million pounds were purchased and 200 million pounds were purchased in each of the years 2001 through 2003 for the LaPorte VCM facility. This agreement expired December 31, 2003. Under the terms of a new agreement, OxyVinyls purchases ethylene for the Deer Park VCM facility and the LaPorte VCM facility at Equistar's weighted average selling price, as defined in the new agreement. The new agreement expires on December 31, 2013. OxyVinyls purchased $286.5 million, $223.3 million and $186.0 million of ethylene from Equistar under the terms of these agreements during the years ended December 31, 2005, 2004 and 2003, respectively. In addition, OxyMar purchased ethylene of $338.2 million and $335.1 million from Equistar during the years ended December 31, 2005 and 2004 and $184.5 million during the period from April 1, 2003 to December 31, 2003, under terms of OCC's agreement with Equistar.

OxyVinyls purchases chlorine from Sunbelt Chlor Alkali Partnership, an equity investee of PolyOne ("Sunbelt"), under the terms of an agreement that expires on December 31, 2094. This agreement requires OxyVinyls to purchase at a market-related price, less a discount, all chlorine produced by Sunbelt at its chlorine manufacturing facility in McIntosh, Alabama, up to a maximum of 250 thousand tons per year. OxyVinyls purchased $76.6 million, $61.1 million and $52.7 million of chlorine from Sunbelt under the terms of this agreement during the years ended December 31, 2005, 2004 and 2003, respectively.

OxyVinyls purchases VCM from OxyMar under the terms of a VCM purchase agreement that is in effect until such time as OPC, either directly or through its affiliates, ceases to own an equity interest in OxyMar. The agreement requires OxyVinyls to purchase a minimum of 700 million of the first 1.1 billion pounds of VCM produced and 530 million pounds of the next 1 billion pounds produced by OxyMar each year at market prices. Total purchases under this agreement were $99.9 million for the three months ended March 31, 2003. With the consolidation of OxyMar, purchases after April 1, 2003 were treated as intercompany transactions and eliminated in consolidation.

Pursuant to raw material purchase agreements, OxyMar purchases substantially all of its principal raw materials at approximate market prices from OCC. Total chlorine purchased from OCC in 2005, 2004, and the nine months ended December 31, 2003 was $230.7 million, $175.0 million and $99.9 million, respectively.

OCC is engaged, under the terms of an operating agreement, to operate and maintain OxyMar's manufacturing facility, the cost of which is reimbursed to OCC by OxyMar. OxyMar also reimburses OCC for steam, electricity, natural gas and other raw materials, along with other operating costs.

OxyMar operating and raw materials costs (in millions):

| | |
|---|---|
| For the year ended December 31, 2005 | $83.0 |
| For the year ended December 31, 2004 | $69.3 |
| For the nine months ended December 31, 2003 | $44.7 |

(14) RELATED PARTY TRANSACTIONS - (continued)

OxyVinyls incurs costs charged by OCC and PolyOne under the terms of various service and shared facilities agreements. These agreements are in effect generally so long as services continue to be provided between parties and/or facilities continue to be shared. Under the provisions of these agreements, OxyVinyls receives from and makes payments to PolyOne and OCC for shared facilities at Louisville, Kentucky, Pedricktown, New Jersey and Pasadena, Texas. In some cases, the agreements contain renewal options at negotiated prices. The net amounts of these costs were approximately $.6 million, $.6 million and $.7 million for the years ended December 31, 2005, 2004 and 2003, respectively. Additionally, OxyVinyls incurred the following costs payable to OCC and PolyOne (in millions):

| | OCC | PolyOne |
|---|---|---|
| Administrative and other support services: | | |
| For the year ended December 31, 2005 | $20.7 | $1.7 |
| For the year ended December 31, 2004 | 21.5 | 1.8 |
| For the year ended December 31, 2003 | 25.9 | 2.2 |
| OxyMar support and services fee: | | |
| For the year ended December 31, 2005 | $ 5.0 | $ -- |
| For the year ended December 31, 2004 | 5.0 | -- |
| For the nine months ended December 31, 2003 | 3.7 | -- |
| Net railcar rent expense (income): | | |
| For the year ended December 31, 2005 | $ 3.1 | $ -- |
| For the year ended December 31, 2004 | 3.1 | -- |
| For the year ended December 31, 2003 | 3.1 | -- |

OxyVinyls had a net payable to OCC of $47.8 million as of December 31, 2005 and a net payable to OCC of $51.9 million as of December 31, 2004.

OxyVinyls had a net receivable from PolyOne of $28.0 million as of December 31, 2005. OxyVinyls had a net payable to PolyOne of $1.0 million as of December 31, 2004. The amounts due to PolyOne do not include trade receivables of $23.8 million payable to ORC by PolyOne as of December 31, 2004. (See Notes 1 and 4.)

(15) WRITE-OFF OF DEER PARK, TEXAS FACILITY -

In December 2001, OxyVinyls announced the temporary idling of its Deer Park, Texas chlor-alkali plant due to low industry capacity utilization and low product market selling prices. The plant had been maintained in a stand-by mode pending strengthening in overall economic conditions. During the third quarter of 2005, OxyVinyls reviewed all of its chemical assets and decided to close its least competitive plants and upgrade certain remaining operations. As a result of this review, OxyVinyls recorded an $84.9 million write-off of the remaining asset value of the chlor-alkali facility and a $7.6 million impairment write-down for an associated dry caustic process. In addition, $3.1 million in dedicated stores and other assets associated with the idled facility were written off. (See Note 6.)

(16) PERMANENT SHUTDOWN OF SCOTFORD, ALBERTA PLANT -

On December 2, 2005, OxyVinyls formally announced that the OxyVinyls PVC plant in Scotford, Alberta would close at the end of January 2006. The decision to shut down the facility was made due to the announced closure of the main raw materials supplier of the Scotford facility. OxyVinyls incurred expenses totaling $6.1 million related to the shutdown. These expenses included $4.1 million under OxyVinyls' severance pay plan, $1.4 million in postretirement healthcare expenses and $.6 million for contract termination costs. (See Note 6.)

(17) VALUATION AND QUALIFYING ACCOUNTS -

Severance expense of $.3 million, $.6 million and $6.1 million was recorded for the years ended December 31, 2005, 2004 and 2003, respectively, for cost reduction and restructuring programs, and these expenses are reflected as selling, general and administrative and other operating expenses. Additional severance expense of $4.1 million was recorded during 2005 for the Scotford plant shutdown, and is reflected as restructuring and asset writedowns in the income statement.

The following table presents the activity of certain valuation and qualifying accounts for the years ended December 31, 2005, 2004 and 2003 (in millions):

| | Balance at Beginning of Period | Charged to Expense | Deductions | Adjustment | Balance at End of Period |
|---|---|---|---|---|---|
| For the year ended December 31, 2005 | | | | | |
| Allowance for doubtful accounts | $ -- | $ -- | $(.2) | $2.1(b) | $ 1.9 |
| Severance and other obligations | $ .3 | $ 4.4 | $(.5)(a) | $ -- | $ 4.2 |
| Deferred tax valuation allowance | $3.0 | $14.4 | $ -- | $ -- | $17.4 |
| For the year ended December 31, 2004 | | | | | |
| Allowance for doubtful accounts | $ -- | $ 1.0 | $ -- | $(1.0)(b) | $ -- |
| Severance and other obligations | $3.8 | $ .6 | $(4.1)(a) | $ -- | $ .3 |
| Deferred tax valuation allowance | $ -- | $ 3.0 | $ -- | $ -- | $ 3.0 |
| For the year ended December 31, 2003 | | | | | |
| Allowance for doubtful accounts | $ -- | $ -- | $(1.1) | $1.1(b) | $ -- |
| Severance and other obligations | $3.3 | $ 6.1 | $(5.6)(a) | $ -- | $ 3.8 |
| Deferred tax valuation allowance | $ -- | $ -- | $ -- | $ -- | $ -- |

(a) Payments under the Partnership's plan for termination and relocation of certain employees

(b) Allowance balance transferred to/from ORC, net

EXHIBIT 99.2

# AUDITED FINANCIAL STATEMENTS

## SUNBELT CHLOR ALKALI PARTNERSHIP
## DECEMBER 31, 2005

.
.
.

SUNBELT CHLOR ALKALI PARTNERSHIP

AUDITED FINANCIAL STATEMENTS

YEARS ENDED DECEMBER 31, 2005 AND 2004

CONTENTS


Audited Financial Statements
Report of Independent Registered Public Accounting Firm..... 1
Balance Sheets............................................. 2
Income Statements.......................................... 3
Statements of Partners' Deficit............................ 4
Statements of Cash Flows................................... 5
Notes to Financial Statements.............................. 6

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Partners
SunBelt Chlor Alkali Partnership

We have audited the accompanying balance sheets of SunBelt Chlor Alkali Partnership as of December 31, 2005 and 2004, and the related statements of income, partners' deficit, and cash flows for each of the three years in the period ended December 31, 2005. These financial statements are the responsibility of the Partnership's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of the Partnership's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of SunBelt Chlor Alkali Partnership at December 31, 2005 and 2004, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2005, in conformity with U.S. generally accepted accounting principles.

February 10, 2006

SUNBELT CHLOR ALKALI PARTNERSHIP

BALANCE SHEETS

| | DECEMBER 31 2005 | DECEMBER 31 2004 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash | $ 44,013 | $ 22,609 |
| Receivable from Oxy Vinyls, LP | 7,015,455 | 7,261,416 |
| Receivables from partners | 17,936,644 | 8,429,290 |
| Inventories | 2,069,896 | 2,111,018 |
| Prepaids and other current assets | 1,291,601 | 1,116,377 |
| Total current assets | 28,357,609 | 18,940,710 |
| Property, plant, and equipment, net | 119,565,930 | 124,415,109 |
| Deferred financing costs, net | 961,774 | 1,041,922 |
| Total assets | $148,885,313 | $144,397,741 |
| **LIABILITIES AND PARTNERS' DEFICIT** | | |
| Current liabilities: | | |
| Amounts payable to partners | $ 7,217,313 | $ 5,811,337 |
| Current portion of long-term debt | 12,187,500 | 12,187,500 |
| Total current liabilities | 19,404,813 | 17,998,837 |
| Long-term debt | 134,062,500 | 146,250,000 |
| Partners' deficit | (4,582,000) | (19,851,096) |
| Total liabilities and partners' deficit | $148,885,313 | $144,397,741 |

See notes to financial statements.

SUNBELT CHLOR ALKALI PARTNERSHIP

INCOME STATEMENTS

| | YEARS ENDED DECEMBER 31 | | |
|---|---|---|---|
| | 2005 | 2004 | 2003 |
| Revenues | $166,967,651 | $105,764,129 | $ 97,021,661 |
| Operating costs and expenses: | | | |
| Cost of sales | 48,699,088 | 45,281,281 | 41,699,987 |
| Depreciation and amortization | 14,347,268 | 14,150,729 | 13,632,976 |
| Administrative and general | 11,694,524 | 10,701,137 | 9,744,589 |
| | 74,740,880 | 70,133,147 | 65,077,552 |
| Operating income | 92,226,771 | 35,630,982 | 31,944,109 |
| Interest expense | (11,455,031) | (12,336,188) | (13,217,344) |
| Interest income | 537,421 | 161,168 | 69,215 |
| Net income | $ 81,309,161 | $ 23,455,962 | $ 18,795,980 |

See notes to financial statements.

SUNBELT CHLOR ALKALI PARTNERSHIP

STATEMENTS OF PARTNERS' DEFICIT

| | PARTNERS | | |
|---|---|---|---|
| | OLIN SUNBELT INC. | 1997 CHLOR ALKALI VENTURE, INC. | TOTAL |
| Balance at December 31, 2002 | $(19,773,097) | $(19,773,097) | $(39,546,194) |
| Cash contributions by partners | 10,883,627 | 14,069,753 | 24,953,380 |
| Asset contributions by partner | 3,186,126 | -- | 3,186,126 |
| Cash distributions to partners | (17,996,146) | (17,996,146) | (35,992,292) |
| Net income | 9,397,990 | 9,397,990 | 18,795,980 |
| Balance at December 31, 2003 | (14,301,500) | (14,301,500) | (28,603,000) |
| Cash distributions to partners | (7,352,029) | (7,352,029) | (14,704,058) |
| Net income | 11,727,981 | 11,727,981 | 23,455,962 |
| Balance at December 31, 2004 | (9,925,548) | (9,925,548) | (19,851,096) |
| Cash distributions to partners | (33,020,033) | (33,020,033) | (66,040,065) |
| Net income | 40,654,581 | 40,654,581 | 81,309,161 |
| Balance at December 31, 2005 | $ (2,291,000) | $ (2,291,000) | $ (4,582,000) |

See notes to financial statements.

SUNBELT CHLOR ALKALI PARTNERSHIP

STATEMENTS OF CASH FLOWS

| | YEARS ENDED DECEMBER 31 | | |
|---|---|---|---|
| | 2005 | 2004 | 2003 |
| OPERATING ACTIVITIES | | | |
| Net income | $ 81,309,161 | $ 23,455,962 | $ 18,795,980 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Depreciation | 14,267,120 | 14,070,581 | 13,552,828 |
| Amortization | 80,148 | 80,148 | 80,148 |
| Loss on disposal of assets | 164,435 | 289,883 | 134,897 |
| Changes in assets and liabilities: | | | |
| Receivable from Oxy Vinyls, LP | 245,961 | (3,834,085) | 1,477,074 |
| Receivables from partners | (9,507,354) | (2,040,479) | (156,701) |
| Inventories | 41,122 | 371,758 | 323,839 |
| Amounts payable to partners | 1,405,976 | (746,222) | 313,383 |
| Prepaid expenses and other current assets | (175,224) | (156,657) | (707,898) |
| Net cash provided by operating activities | 87,831,345 | 31,490,889 | 33,813,550 |
| INVESTING ACTIVITIES | | | |
| Purchases of property, plant, and equipment | (9,645,152) | (4,588,322) | (10,575,538) |
| Proceeds on sale of property, plant, and equipment | 62,776 | -- | -- |
| Net cash used in investing activities | (9,582,376) | (4,588,322) | (10,575,538) |
| FINANCING ACTIVITIES | | | |
| Cash contributions by partners | -- | -- | 24,953,380 |
| Cash distributions to partners | (66,040,065) | (14,704,058) | (35,992,292) |
| Principal payments on long-term debt | (12,187,500) | (12,187,500) | (12,187,500) |
| Net cash used in financing activities | (78,227,565) | (26,891,558) | (23,226,412) |
| Net increase in cash | 21,404 | 11,009 | 11,600 |
| Cash at beginning of year | 22,609 | 11,600 | -- |
| Cash at end of year | $ 44,013 | $ 22,609 | $ 11,600 |

See notes to financial statements.

## NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 2005 AND 2004

### 1. ORGANIZATION

SunBelt Chlor Alkali Partnership (the Partnership) was formed on August 23, 1996 under a Partnership Agreement, between 1997 Chlor Alkali Venture, Inc. and Olin SunBelt Inc. (the Partners). 1997 Chlor Alkali Venture, Inc. is a wholly owned subsidiary of PolyOne Corporation (formerly The Geon Company) and Olin SunBelt Inc. is a wholly owned subsidiary of the Olin Corporation. Each of the Partners has a 50% interest in the Partnership. The Partnership Agreement provides that the capital investment of the Partners will be maintained and the Partnership's income or loss will be allocated to the Partners based on their ownership interest percentages.

The Partnership was formed for the purpose of construction and operation of a Chlor-Alkali facility. The facility, which is located in McIntosh, Alabama produces chlorine, caustic soda and hydrogen.

### 2. SIGNIFICANT ACCOUNTING POLICIES

#### CASH AND CASH EQUIVALENT

The Partnership considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

#### INVENTORIES

Inventories are valued at the lower of cost or market. Cost is determined by the first-in, first-out (FIFO) method.

#### PROPERTY, PLANT, AND EQUIPMENT AND DEPRECIATION

Property, plant, and equipment are carried at cost. Major renewals and betterments are capitalized. Maintenance and repair expenditures which do not improve or extend the life of the respective assets are expensed as incurred. Depreciation for all plant and equipment is computed using the straight-line method over their estimated useful lives. The ranges of estimated useful lives are as follows:

| | |
|---|---|
| Land improvements | 20 years |
| Buildings | 20 years |
| Machinery and equipment | 15-20 years |

Long-lived assets are assessed for impairment when operating profits for the related business or a significant change in the use of an asset indicate that their carrying value may not be recoverable.

#### DEFERRED FINANCING COSTS

The costs incurred by the Partnership in obtaining its long-term debt have been capitalized and are being amortized over the term of the debt using the effective interest method.

#### FINANCIAL INSTRUMENTS

The carrying amount of long-term debt approximates its fair value. The fair value of the debt is estimated based on the present value of the underlying cash flow discounted at the Partnership's estimated borrowing rate.

#### REVENUE RECOGNITION

The Partnership recognizes revenues at the point of passage of title which is based on shipping terms.

### SHIPPING AND HANDLING COSTS

Shipping and handling costs are reflected in costs of sales.

### INCOME TAXES

No provision is made for income taxes as the Partnership's results of operations are includable in the tax returns of the Partners.

### USE OF ESTIMATES

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and the accompanying notes. Actual results could differ from those estimates.

### RISKS AND UNCERTAINTIES

Since the Partnership's major products are commodities, significant changes in the prices of chemical products could have a significant impact on the results of operations for any particular period. The Partnership had one major chlorine customer, Oxy Vinyls LP, during the periods presented, which accounted for 45.7%, 58.3%, and 53.7% of total sales for the years ended December 31, 2005, 2004, and 2003, respectively.

## 3. INVENTORIES

Inventories are comprised as follows:

| | DECEMBER 31 | |
|---|---|---|
| | 2005 | 2004 |
| Finished goods | $ 619,117 | $ 521,364 |
| Parts | 1,450,779 | 1,589,654 |
| | $2,069,896 | $2,111,018 |

## 4. PROPERTY, PLANT, AND EQUIPMENT

Property, plant, and equipment are comprised as follows:

| | DECEMBER 31 | |
|---|---|---|
| | 2005 | 2004 |
| Land and land improvements | $ 4,862,826 | $ 4,862,826 |
| Building | 3,869,389 | 3,507,389 |
| Machinery and equipment | 209,229,631 | 200,964,285 |
| Construction in process | 3,734,366 | 3,968,774 |
| | 221,696,212 | 213,303,274 |
| Less allowance for depreciation | 102,130,282 | 88,888,165 |
| | $119,565,930 | $124,415,109 |

## 5. TRANSACTIONS WITH AFFILIATES

The Partnership has various management service agreements, dated August 23, 1996, with the Olin Corporation. These agreements, which include compensation for managing the facility, an asset utilization fee, a fleet fee and a distribution fee, have terms from five to ten years with five year price adjustment renewals.

Charges for these services were approximately $7,551,933, $7,199,412, and $6,813,237 for 2005, 2004, and 2003, respectively, and have been included within administrative and general expenses in the statement of operations. The Partnership also received contributions from its partners totaling $28,139,506 in 2003, which was used for working capital purposes and to pay for costs incurred in constructing the production facility. The cash policy was changed during 2003 to not make distributions to the partners until the cash balance was sufficient to cover both the principal payment and the interest expense for the year. Contributions from the partners were discontinued with this policy change and the manufacturing costs were paid from receipts. The Partnership made distributions to its partners totaling $66,040,065, $14,704,058, and $35,992,292 in 2005, 2004, and 2003, respectively.

In accordance with the Partnership Operating Agreement, the majority of chlorine produced by the Partnership is sold to Oxy Vinyls LP, which is 24% owned by PolyOne Corporation. The remaining chlorine and all of the caustic soda produced by the Partnership is marketed and distributed by the Olin Corporation.

## 6. LONG-TERM DEBT

On December 23, 1997, the Partnership borrowed $195,000,000 in a private placement of debt. The debt is secured by the property, plant, equipment, and inventory of the Partnership. The term of the loan is 20 years at an interest rate of 7.23%. The first principal payment of $12,187,500 was paid on December 22, 2002 with equal annual payments due through December 22, 2017. Interest payments are payable semi-annually in arrears on each June 22 and December 22. Interest payments totaled $11,455,031, $12,336,188, and 13,217,344 in 2005, 2004, and 2003, respectively. The debt is guaranteed by the Partners.

## 7. LEASES

The Partnership has operating leases for certain property, machinery, and equipment. At December 31, 2005, future minimum lease payments under noncancelable operating leases are as follows:

| | |
|---|---|
| 2006 | $ 2,156,701 |
| 2007 | 2,269,468 |
| 2008 | 1,986,528 |
| 2009 | 1,932,708 |
| 2010 | 1,681,248 |
| Thereafter | 8,464,282 |
| Total minimum future lease payments | $18,490,935 |

Rent expense was approximately $722,695, $599,720, and $557,260 for the years ended December 31, 2005, 2004, and 2003 respectively.

## 8. COMMITMENTS AND CONTINGENCIES

The Partnership is subject to legal proceedings and claims that arise in the ordinary course of its business. Management evaluates each claim and provides for any potential loss when the claim is probable to be paid and reasonably estimable. In the opinion of management, the ultimate liability with respect to these actions will not materially affect the financial condition, results of operations or cash flows of the Partnership.