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

# FORM 10-Q

☑ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

**For the quarterly period ended June 30, 2006**

o **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

**For the transition period from __________ to __________.**

**Commission file number 1-16091**

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

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

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

Former name, former address and former fiscal year, in changed since last report: **Not Applicable**

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☑ No o

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

Large accelerated filer ☑ Accelerated filer o 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 number of outstanding shares of the registrant's common stock, $0.01 par value, as of July 31, 2006 was 92,671,265.

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**Part I — Financial Information**

**Item 1. Financial Statements**

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| Sales | $ 686.4 | $ 620.4 | $ 1,361.0 | $ 1,232.2 |
| Operating costs and expenses: | | | | |
| Cost of sales | 592.7 | 538.7 | 1,176.3 | 1,072.0 |
| Selling and administrative | 49.9 | 47.8 | 99.2 | 94.9 |
| Depreciation and amortization | 14.3 | 12.4 | 28.6 | 24.9 |
| Employee separation and plant phaseout | (0.2) | 0.4 | (0.3) | 0.6 |
| Environmental remediation at inactive sites | (2.3) | — | (4.1) | — |
| Income from equity affiliates and minority interest | (31.5) | (32.1) | (70.1) | (58.1) |
| Operating income | 63.5 | 53.2 | 131.4 | 97.9 |
| Interest expense | (16.8) | (17.4) | (33.4) | (34.2) |
| Interest income | 0.8 | 0.4 | 1.3 | 0.9 |
| Premium on early extinguishment of long-term debt | (1.2) | — | (1.2) | — |
| Other expense, net | (1.5) | (0.8) | (2.7) | (1.6) |
| Income before income taxes and discontinued operations | 44.8 | 35.4 | 95.4 | 63.0 |
| Income tax expense | (2.4) | (2.4) | (4.1) | (5.0) |
| Income before discontinued operations | 42.4 | 33.0 | 91.3 | 58.0 |
| Loss from discontinued operations, net of income taxes | — | (1.7) | (2.1) | (13.3) |
| Net income | $ 42.4 | $ 31.3 | $ 89.2 | $ 44.7 |
| Earnings (loss) per common share: | | | | |
| Basic earnings (loss): | | | | |
| Before discontinued operations | $ 0.46 | $ 0.36 | $ 0.99 | $ 0.63 |
| Discontinued operations | — | (0.02) | (0.02) | (0.14) |
| Basic earnings per share | $ 0.46 | $ 0.34 | $ 0.97 | $ 0.49 |
| Diluted earnings (loss): | | | | |
| Before discontinued operations | $ 0.46 | $ 0.36 | $ 0.99 | $ 0.63 |
| Discontinued operations | — | (0.02) | (0.03) | (0.14) |
| Diluted earnings per share | $ 0.46 | $ 0.34 | $ 0.96 | $ 0.49 |
| Weighted average shares used to compute earnings per share: | | | | |
| Basic | 92.4 | 91.8 | 92.2 | 91.8 |
| Diluted | 93.0 | 92.1 | 92.6 | 92.1 |
| Dividends paid per share of common stock | $ — | $ — | $ — | $ — |

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

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

| | June 30, 2006 | December 31, 2005 |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 75.0 | $ 32.8 |
| Accounts receivable, net | 379.9 | 320.5 |
| Inventories | 228.2 | 191.8 |
| Deferred income tax assets | 19.6 | 20.1 |
| Other current assets | 18.2 | 27.4 |
| Discontinued operations | — | 20.9 |
| Total current assets | 720.9 | 613.5 |
| Property, net | 423.0 | 436.0 |
| Investment in equity affiliates | 302.7 | 273.9 |
| Goodwill | 315.3 | 315.3 |
| Other intangible assets, net | 9.6 | 10.6 |
| Other non-current assets | 64.4 | 60.0 |
| Discontinued operations | — | 6.7 |
| Total assets | $ 1,835.9 | $ 1,716.0 |
| **Liabilities and Shareholders’ Equity** | | |
| Current liabilities: | | |
| Short-term bank debt | $ 4.6 | $ 7.1 |
| Accounts payable | 277.3 | 232.6 |
| Accrued expenses | 84.9 | 82.4 |
| Current portion of long-term debt | 19.3 | 0.7 |
| Discontinued operations | — | 11.2 |
| Total current liabilities | 386.1 | 334.0 |
| Long-term debt | 603.7 | 638.7 |
| Post-retirement benefits other than pensions | 103.5 | 107.9 |
| Other non-current liabilities, including pensions | 221.4 | 214.3 |
| Minority interest in consolidated subsidiaries | 5.9 | 5.4 |
| Total liabilities | 1,320.6 | 1,300.3 |
| Shareholders’ equity | 515.3 | 415.7 |
| Total liabilities and shareholders’ equity | $ 1,835.9 | $ 1,716.0 |

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

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

| | Six Months Ended June 30, 2006 | Six Months Ended June 30, 2005 (revised – see note C) |
|---|---|---|
| **Operating Activities** | | |
| Net income | $ 89.2 | $ 44.7 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Employee separation and plant phaseout charge (benefit) | (0.3) | 0.6 |
| Cash payments for employee separation and plant phaseout | (1.2) | (1.9) |
| Environmental remediation insurance benefit, net of charges at inactive sites | (4.1) | — |
| Environmental remediation insurance receipts, net of (spending) at inactive sites | 4.9 | (9.9) |
| Depreciation and amortization | 28.6 | 24.9 |
| Premium on early extinguishment of long term debt | 1.2 | — |
| Loss on disposition of discontinued businesses and related plant phaseout charge | 2.3 | 11.6 |
| Companies carried at equity and minority interest: | | |
| Income from equity affiliates and minority interest | (70.1) | (58.1) |
| Dividends and distributions received | 42.2 | 19.2 |
| Provision for deferred income taxes | 0.5 | 0.9 |
| Change in assets and liabilities: | | |
| Accounts receivable | (43.4) | (53.2) |
| Inventories | (16.4) | (9.4) |
| Accounts payable | 31.7 | 16.3 |
| Increase (decrease) in sale of accounts receivable | (7.9) | 38.6 |
| Accrued expenses and other | (10.9) | (17.9) |
| Net cash (used) provided by discontinued operations | (0.1) | 4.7 |
| **Net cash provided by operating activities** | 46.2 | 11.1 |
| **Investing Activities** | | |
| Capital expenditures | (12.5) | (18.0) |
| Business acquisitions, net of cash received | — | (2.7) |
| Proceeds from sale of assets | 7.2 | 8.4 |
| Proceeds from sale of discontinued business, net | 17.3 | — |
| Net cash used by discontinued operations | (0.2) | (0.7) |
| **Net cash provided (used) by investing activities** | 11.8 | (13.0) |
| **Financing Activities** | | |
| Change in short-term debt | (2.4) | 1.0 |
| Repayment of long-term debt | (17.0) | (1.5) |
| Proceeds from exercise of stock options | 2.8 | 0.3 |
| **Net cash used by financing activities** | (16.6) | (0.2) |
| Effect of exchange rate changes on cash | 0.8 | (1.8) |
| **Increase (decrease) in cash and cash equivalents** | 42.2 | (3.9) |
| Cash and cash equivalents at beginning of period | 32.8 | 38.6 |
| **Cash and cash equivalents at end of period** | $ 75.0 | $ 34.7 |

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

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

| | Common Shares | Common Shares Held in Treasury | Total | Common Stock | Additional Paid-In Capital | Retained Earnings (Deficit) | Common Stock Held in Treasury | Accumulated Other Comprehensive Income |
|---|---|---|---|---|---|---|---|---|
| **Balance January 1, 2005** | 122,192 | 30,480 | $ 380.4 | $ 1.2 | $ 1,069.8 | $ (208.9) | $ (339.0) | $ (142.7) |
| Comprehensive income: | | | | | | | | |
| Net income | | | 13.4 | | | 13.4 | | |
| Translation adjustment | | | (5.3) | | | | | (5.3) |
| Total comprehensive income | | | 8.1 | | | | | (5.3) |
| Stock-based compensation and benefits | | (98) | 1.0 | | (0.2) | | 0.9 | 0.3 |
| **Balance March 31, 2005** | 122,192 | 30,382 | $ 389.5 | $ 1.2 | $ 1,069.6 | $ (195.5) | $ (338.1) | $ (147.7) |
| Comprehensive income: | | | | | | | | |
| Net income | | | 31.3 | | | 31.3 | | |
| Translation adjustment | | | (6.0) | | | | | (6.0) |
| Total comprehensive income | | | 25.3 | | | | | (6.0) |
| Stock-based compensation and benefits | | (36) | (0.9) | | (0.2) | | 0.2 | (0.9) |
| **Balance June 30, 2005** | 122,192 | 30,346 | $ 413.9 | $ 1.2 | $ 1,069.4 | $ (164.2) | $ (337.9) | $ (154.6) |
| **Balance January 1, 2006** | 122,192 | 30,255 | $ 415.7 | $ 1.2 | $ 1,066.4 | $ (162.0) | $ (337.1) | $ (152.8) |
| Comprehensive income: | | | | | | | | |
| Net income | | | 46.8 | | | 46.8 | | |
| Translation adjustment | | | 0.9 | | | | | 0.9 |
| Total comprehensive Income | | | 47.7 | | | | | 0.9 |
| Stock-based compensation and benefits | | (550) | 3.1 | | (0.2) | | 4.0 | (0.7) |
| **Balance March 31, 2006** | 122,192 | 29,705 | $ 466.5 | $ 1.2 | $ 1,066.2 | $ (115.2) | $ (333.1) | $ (152.6) |
| Comprehensive income: | | | | | | | | |
| Net income | | | 42.4 | | | 42.4 | | |
| Translation adjustment | | | 5.2 | | | | | 5.2 |
| Total comprehensive Income | | | 47.6 | | | | | 5.2 |
| Stock-based compensation and benefits | | (163) | 1.2 | | (0.3) | | 1.5 | |
| **Balance June 30, 2006** | 122,192 | 29,542 | $ 515.3 | $ 1.2 | $ 1,065.9 | $ (72.8) | $ (331.6) | $ (147.4) |

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

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

**Note A — Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with Form 10-Q instructions and in the opinion of management contain all adjustments, consisting of normal recurring accruals, necessary to present fairly the financial position, results of operations and cash flows for the periods presented. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates. These interim financial statements should be read in conjunction with the financial statements and accompanying notes included in the Annual Report on Form 10-K for the year ended December 31, 2005 of PolyOne Corporation.

Operating results for the three-month and six-month periods ended June 30, 2006 are not necessarily indicative of the results that may be attained in subsequent quarters or for the year ending December 31, 2006.

PolyOne sold 82% of its Engineered Films business in February 2006. Through the third quarter of 2003, Engineered Films was included in the Performance Plastics segment. Since then, it has been treated as a discontinued operation. As a result, all historical information included in this quarterly report for the Engineered Films business is presented as a discontinued operation. Unless otherwise noted, the disclosures in these financial statements pertain to PolyOne's continuing operations.

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 for all historic periods presented. Specialty Resins is now included in the Performance Plastics segment, where it had been previously.

**Note B — Discontinued Operations**

PolyOne sold 82% of its Engineered Films business in February 2006 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 retained an 18% ownership interest in the company. Under Emerging Issues Task Force (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 component 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 has no significant influence or continuing involvement in the new entity. Activities that would be considered continuing cash flows (consisting of warehousing and short-term transitional services) amount to less than one percent of the new entity's corresponding costs and, therefore, are not considered significant. The operations and cash flows of the business sold have been eliminated from the financial statements of the ongoing operations of PolyOne. PolyOne also considered the provisions of Financial Accounting Standards Board (FASB) Interpretation No. 46, "Consolidation of Variable Interest Entities," and determined that the new entity is not a variable interest entity subject to consolidation. As a result, the retained minority interest investment in the Engineered Films business is reported on the cost method of accounting.

Included in the results of the first six months of 2006 was a pre-tax charge of $2.3 million to adjust the net assets of the Engineered Films business to the net proceeds that were received and to recognize costs that were not able to be recognized until the Engineered Films business was sold due to the contingent nature of these costs, as required by generally accepted accounting principles. For the six-month period ended June 30, 2005, a pre-tax charge of $10.9 million was recorded to adjust the net assets of the Engineered Films business to the projected net proceeds to be received from the sale.

The following table summarizes the results for businesses that were reported as discontinued operations for the periods indicated:

| (In millions) | Three Months Ended June 30, 2006 | Three Months Ended June 30, 2005 | Six Months Ended June 30, 2006 | Six Months Ended June 30, 2005 |
|---|---|---|---|---|
| Sales | $ — | $ 31.1 | $ 9.6 | $ 61.1 |
| Pre-tax income (loss) from operations | $ — | $ (1.7) | $ 0.2 | $ (1.7) |
| Pre-tax loss on disposition of business | — | — | (2.3) | (11.6) |
| Income tax expense (net of valuation allowance) | — | — | — | — |
| Loss from discontinued operations | $ — | $ (1.7) | $ (2.1) | $ (13.3) |

**Note C — Accounting Policies**

**Share-Based Compensation —** As of June 30, 2006, PolyOne has one active share-based employee compensation plan, which is described more fully in Note H to the Condensed Consolidated Financial Statements. Prior to January 1, 2006, PolyOne accounted for share-based compensation under the provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" (APB No. 25). Under APB No. 25, compensation cost for stock options was measured as the excess, if any, of the quoted market price of PolyOne common stock at the date of the grant over the amount an option holder must pay to acquire the common stock. Compensation cost for stock appreciation rights (SARs) was recognized upon vesting as the amount by which the quoted market value of the shares of PolyOne common stock covered by the grant exceeded the SARs specified value.

On January 1, 2006, PolyOne adopted Statement of Financial Accounting Standards (SFAS) No. 123(R), "Share-Based Payment" (SFAS No. 123(R)), using the modified prospective transition method. SFAS No. 123(R) requires the Company to estimate the fair value of share-based awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service periods in the Company's Consolidated Statement of Operations. Under the modified prospective transition method, compensation cost recognized during the three-month and six-month periods ended June 30, 2006 includes (a) compensation cost for all share-based payments granted prior to, but not yet vested as of, January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, plus (b) compensation cost for all share-based payments granted on or subsequent to January 1, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123(R). The Condensed Consolidated Financial Statements as of and for the three-month and six-month periods ended June 30, 2006 reflect the impact of SFAS No. 123(R). In accordance with the modified prospective transition method, the Condensed Consolidated Financial Statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS No. 123(R). Total share-based compensation cost for the three-month and six-month periods ended June 30, 2006 was $0.8 million and $2.2 million, respectively, net of tax.

The adoption of SFAS No. 123(R) on January 1, 2006 resulted in compensation cost for the three-month period ended June 30, 2006 of $0.8 million more than what it would have been under APB No. 25, or $0.01 per share. For the six months ended June 30, 2006, the compensation cost recorded under SFAS No. 123(R) was $2.2 million, or $0.2 per share, which is the same amount that would have been recognized under APB No. 25.

SFAS No. 123(R) requires that the benefits of tax deductions in excess of compensation cost recognized be reported as a financing cash flow, rather than as an operating cash flow as was previously required. This requirement will reduce net operating cash flows and increase net financing cash flows. However, because PolyOne is in a net operating loss carryforward position for income taxes, there was no impact on its cash flow statement for the six-month period ended June 30, 2006.

The following table illustrates the effect on net income and income per share for the three-month and six-month periods ended June 30, 2005 as if PolyOne had applied the fair value recognition provisions of SFAS No. 123 to share-based employee compensation using the fair value estimate computed by the Black-Scholes-Merton option-pricing model for the three-month and six-month periods ended June 30, 2005. 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. In addition, option valuation models use highly subjective assumptions, including expected share price volatility.

| (In millions, except per share data) | Three Months Ended June 30, 2005 | Six Months Ended June 30, 2005 |
|---|---|---|
| Net income, as reported | $ 31.3 | $ 44.7 |
| Add: Total share-based employee compensation benefit included in reported net income, net of tax | (0.8) | (0.4) |
| Deduct: Total share-based employee compensation expense determined under the fair value-based method for all awards, net of tax | (1.0) | (2.0) |
| Pro forma net income | $ 29.5 | $ 42.3 |
| Net earnings per share: | | |
| Basic and diluted — as reported | $ 0.34 | $ 0.49 |
| Basic and diluted — pro forma | $ 0.32 | $ 0.46 |

**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 accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material. SFAS No. 151 requires these items to be recognized as current-period charges and that fixed production overhead be allocated to conversion costs 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 has not had, nor is it 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 changes in accounting principle to 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 has not had, nor is it expected to have, a material impact on the Company’s financial position or results of operations.

In June 2006, the FASB issued FASB Interpretation No. 48 (FIN 48), "Accounting for Uncertainty in Income Taxes — an interpretation of FASB Statement No. 109, Accounting for Income Taxes," which is effective for fiscal years beginning after December 15, 2006. FIN 48 clarifies the recognition threshold and measurement attributes for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company is currently evaluating the impact the adoption of FIN 48 may have on its financial statements.

**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 Condensed Consolidated Financial Statements include, but are not limited to, 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 that are used to determine pension and post-retirement employee benefit expenses. Actual results could differ from these estimates.

**Reclassification —** Certain amounts for 2005 have been reclassified to conform to the 2006 presentation.

**Consolidated Statements of Cash Flows —** For the six months ended June 30, 2005, PolyOne has separately disclosed the operating, investing and financing portions of the cash flows that were attributable to its discontinued operations to conform with the presentation shown for the six months ended June 30, 2006 and with the presentation in PolyOne's Annual Report on Form 10-K for the year ended December 31, 2005. In periods prior to December 31, 2005, cash flows that were attributable to discontinued operations were reported on a combined basis on one separate line item.

**Note D — Goodwill and Intangible Assets**

During the six months ended June 30, 2006, there were no acquisitions, disposals or impairment of PolyOne's goodwill. Goodwill as of June 30, 2006 and December 31, 2005, by business segment, was as follows:

| (In millions) | Performance Plastics | Distribution | Total |
|---|---|---|---|
| June 30, 2006 and December 31, 2005 | $ 313.7 | $ 1.6 | $ 315.3 |

Information regarding PolyOne's other intangible assets follows:

| | As of June 30, 2006 | | | |
|---|---|---|---|---|
| (In millions) | Acquisition Cost | Accumulated Amortization | Currency Translation | Net |
| Non-contractual customer relationships | $ 8.6 | $ (5.9) | $ — | $ 2.7 |
| Sales contract | 9.6 | (8.7) | — | 0.9 |
| Patents, technology and other | 7.3 | (2.4) | 1.1 | 6.0 |
| Total | $ 25.5 | $ (17.0) | $ 1.1 | $ 9.6 |

| (In millions) | As of December 31, 2005 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 |

Amortization of other intangible assets was $0.4 million and $0.6 million for the three-month periods ended June 30, 2006 and 2005, respectively, and $1.0 million and $1.3 million for the six-month periods ended June 30, 2006 and 2005, respectively.

The carrying values of intangible assets and other investments are adjusted to the estimated net future cash flows based upon an evaluation done each year end, or more often, when indicators of impairment exist. For the six-month period ended June 30, 2006 there were no indicators of impairment for either goodwill or intangible assets.

**Note E — Inventories**

Components of inventories are as follows:

| (In millions) | June 30, 2006 | December 31, 2005 |
|---|---|---|
| Finished products and in-process inventories | $ 172.7 | $ 155.0 |
| Raw materials and supplies | 96.3 | 86.8 |
| | 269.0 | 241.8 |
| LIFO reserve | (40.8) | (50.0) |
| Total | $ 228.2 | $ 191.8 |

**Note F — Income Taxes**

Income tax expense for each of the three months ended June 30, 2006 and 2005 was $2.4 million. For the six months ended June 30, 2006 and 2005, income tax expense was $4.1 million and $5.0 million, respectively. The effective tax rate for each period presented is lower than the federal statutory rate due to utilizing net operating loss carryforwards for which valuation allowances had been previously provided. For the second quarter and first half of 2006, a tax provision was recorded for federal alternative minimum tax, various state income taxes and foreign taxes. A domestic tax provision was not applied against income before income taxes in either the second quarter or the first half of 2005. Tax expense for 2005 represents foreign taxes. In accordance with SFAS No. 109, “Accounting for Income Taxes,” due to the uncertainty regarding the full utilization of the Company’s deferred income taxes, PolyOne intends to maintain the valuation allowance until additional realization events occur, including the generation of future sustainable taxable income, that would support reversal of all or a portion of the allowance. Tax expense for each period primarily represents foreign, state and local taxes, while tax expense for the second quarter and first half of 2006 also includes $0.3 million and $0.5 million, respectively, for federal alternative minimum taxes.

**Note G — Investment in Equity Affiliates**

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

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PolyOne owns 24% of Oxy Vinyls, LP (OxyVinyls), a manufacturer and marketer of PVC resins. OxyVinyls is a leading producer of PVC resins in North America. The following table presents OxyVinyls' summarized financial results for the periods indicated:

| (Dollars in millions) | Three Months Ended June 30, 2006 | Three Months Ended June 30, 2005 | Six Months Ended June 30, 2006 | Six Months Ended June 30, 2005 |
|---|---|---|---|---|
| Net sales | $ 647.2 | $ 621.4 | $ 1,340.3 | $ 1,236.9 |
| Operating income | 62.9 | 97.6 | 169.8 | 181.7 |
| Partnership income as reported by OxyVinyls | 68.1 | 82.3 | 170.0 | 144.6 |
| PolyOne's ownership of OxyVinyls | 24% | 24% | 24% | 24% |
| PolyOne's proportionate share of OxyVinyls' earnings | 16.3 | 19.8 | 40.8 | 34.7 |
| Amortization of the difference between PolyOne's investment and its underlying share of OxyVinyls' equity | 0.2 | 0.1 | 0.3 | 0.3 |
| Equity affiliate earnings recorded by PolyOne | $ 16.5 | $ 19.9 | $ 41.1 | $ 35.0 |

| (In millions) | June 30, 2006 | December 31, 2005 |
|---|---|---|
| Current assets | $ 457.6 | $ 467.3 |
| Non-current assets | 1,265.0 | 1,234.8 |
| Total assets | 1,722.6 | 1,702.1 |
| Current liabilities | 264.4 | 276.0 |
| Non-current liabilities | 328.1 | 376.0 |
| Total liabilities | 592.5 | 652.0 |
| Partnership capital | $ 1,130.1 | $ 1,050.1 |

PolyOne also owns 50% of SunBelt Chlor-Alkali Partnership (SunBelt). The following table presents SunBelt's summarized financial results for the periods indicated:

| (Dollars in millions) | Three Months Ended June 30, 2006 | Three Months Ended June 30, 2005 | Six Months Ended June 30, 2006 | Six Months Ended June 30, 2005 |
|---|---|---|---|---|
| Net sales | $ 51.6 | $ 43.0 | $ 95.7 | $ 81.5 |
| Operating income | 29.7 | 23.4 | 57.4 | 44.4 |
| Partnership income as reported by SunBelt | 27.4 | 20.7 | 52.6 | 38.9 |
| PolyOne's ownership of SunBelt | 50% | 50% | 50% | 50% |
| Equity affiliate earnings recorded by PolyOne | $ 13.7 | $ 10.4 | $ 26.3 | $ 19.5 |

| (In millions) | June 30, 2006 | December 31, 2005 |
|---|---|---|
| Current assets | $ 48.4 | $ 28.4 |
| Non-current assets | 114.8 | 120.5 |
| Total assets | 163.2 | 148.9 |
| Current liabilities | 18.5 | 19.4 |
| Non-current liabilities | 134.1 | 134.1 |
| Total liabilities | 152.6 | 153.5 |
| Partnership capital (deficit) | $ 10.6 | $ (4.6) |

OxyVinyls purchases chlorine from SunBelt under an agreement that expires in 2094. The agreement requires OxyVinyls to purchase all of the chlorine produced by SunBelt up to 250,000 tons per year at market price, less a discount.

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 is presented below. The amounts shown represent the entire operations of these businesses.

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| (In millions) | 2006 | 2005 | 2006 | 2005 |
| Net sales | $34.3 | $33.2 | $65.9 | $64.0 |
| Operating income | $ 3.4 | $ 3.7 | $ 6.6 | $ 7.5 |
| Net income | $ 3.0 | $ 3.5 | $ 6.0 | $ 6.9 |

**Note H — Share-Based Compensation**

Share-based compensation cost is based on the value of the portion of share-based payment awards that are ultimately expected to vest during the period. Share-based compensation cost recognized in the Company's Condensed Consolidated Statement of Operations for the first half of 2006 includes (a) compensation cost for share-based payment awards granted prior to, but not yet vested, as of January 1, 2006 based on the grant date fair value estimated in accordance with the pro forma provisions of SFAS No. 123, plus (b) compensation cost for share-based payment awards granted on or subsequent to January 1, 2006 based on the grant date fair value estimated in accordance with the provision of SFAS No. 123(R). Because share-based compensation expense recognized in the Condensed Consolidated Statement of Operations for the first half of 2006 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS No. 123(R) requires that forfeitures be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. In the Company's pro forma information that was required under SFAS No. 123 for the first half of 2005, the Company accounted for forfeitures as they occurred.

PolyOne has one active share-based compensation plan, which is described below. The pre-tax and after-tax compensation cost recognized for the three months and six months ended June 30, 2006 was $0.8 million and $2.2 million, respectively. For the three months and six months ended June 30, 2005, PolyOne recognized a benefit of $0.8 million and $0.4 million, respectively. This activity is included in selling and administrative expenses in the Condensed Consolidated Statement of Operations.

**2005 Equity and Performance Incentive Plan**

In May 2005, PolyOne's shareholders approved the PolyOne Corporation 2005 Equity and Performance Incentive Plan (2005 EPIP). All future grants and awards will be issued only from this plan. As a result, all previous equity-based plans were frozen in May 2005. The 2005 EPIP provides for the award of a broad variety of share-based compensation alternatives such as non-qualified stock options, incentive stock options, restricted stock, restricted stock units, performance shares, performance units and stock appreciation rights. Five million shares of common stock have been reserved for future grants and awards under the 2005 EPIP. It is anticipated that all share-based grants and awards that are exercised will be issued from shares of PolyOne common stock that are held in treasury.

**Stock Appreciation Rights**

During the first quarter of 2006, the Compensation and Governance Committee of the Company's Board of Directors authorized the issuance of 1,029,300 stock appreciation rights (SARs). The awards were approved and communicated on January 4, 2006 for certain employees and on February 21, 2006 for the Chief Executive Officer. These dates have been used as the grant dates for valuation purposes. The grant

date stock price was $6.51 for the January 4, 2006 grant and $9.19 for the February 21, 2006 grant. Vesting is based on a service period of one year and the achievement of stock price targets. This condition is considered a market-based measure under SFAS No. 123(R) and is considered in determining the grant's fair value. This fair value is not subsequently revised for actual market price achievement, but rather is a fixed expense subject only to service-related forfeitures. The awards vest in one-third increments based on stock price achievement of $7.50, $8.50 and $10.00 per share, but may not be exercised earlier than one year from the date of the grant. The SARs have seven-year exercise periods that expire on January 4, 2013 and February 21, 2013.

The option pricing model used by PolyOne to value the SARs granted during the first quarter of 2006 was a Monte Carlo simulation method. Under this method, the fair value of awards on the date of grant is an estimate and is affected by the Company's stock price, as well as by assumptions regarding a number of highly complex and subjective variables that are presented in the following table. Expected volatility was determined by the six-year historical weekly average volatility for PolyOne's common stock and the implied volatility rates for exchange-traded options. The expected term of options granted was set equal to halfway between the vesting and expiration dates for each grant. Dividends were not included in this calculation because PolyOne does not currently pay dividends. The risk-free rate of return for periods within the contractual life of the option is based on U.S. Treasury rates that were in effect at the time of the grant. Forfeitures were estimated at 3% per year based on PolyOne's historical experience. Following is a summary of the assumptions related to the grants issued during the first quarter of 2006:

| | 2006 |
|---|---|
| Expected volatility | 44.00% |
| Expected dividends | — |
| Expected term (in years) | 3.7 — 4.3 |
| Risk-free rate | 4.26% — 4.57% |
| Value of SAR options granted | $ 2.63 — $3.82 |

In January 2005, the Compensation and Governance Committee authorized the issuance of 474,300 SARs. The fair value of the SARs was $4.18 per share and was calculated using the Black-Scholes-Merton valuation method. The SARs will be issued in shares of PolyOne common stock and vest in one-third increments when PolyOne's common stock price increases by 10%, 20% and 30% above the $8.94 per share base price. The SARs have a seven-year exercise period that expires on January 4, 2012.

In December 2003, the Compensation and Governance Committee authorized the issuance of 1,300,000 SARs with an exercise term of 36 months. The SARs will be issued in shares of PolyOne common stock and vest in one-third increments upon attaining target prices of $8.00, $9.00 and $10.00 per share of PolyOne's common stock.

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A summary of SAR activity under the 2005 EPIP as of June 30, 2006 and changes during the six months then ended are presented below:

| Stock Appreciation Rights | Shares (in thousands) | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term | Aggregate Intrinsic Value (in millions) |
|---|---|---|---|---|
| Outstanding at January 1, 2006 | 1,528 | $ 7.40 | | |
| Granted | 1,029 | 6.96 | | |
| Exercised | (422) | 6.13 | | |
| Forfeited or expired | (90) | 7.36 | | |
| Outstanding at June 30, 2006 | 2,045 | $ 7.45 | 4.9 years | $ 3.1 |
| Vested at June 30, 2006 | 1,068 | $ 7.53 | 5.3 years | $ 1.6 |
| Exercisable at June 30, 2006 | 417 | $ 8.37 | 3.5 years | $ 0.4 |

There were no SARs granted during the three months ended June 30, 2006 and 2005. The total intrinsic value of SARs that were exercised during the three months ended June 30, 2006 and 2005 was $0.2 million and $0, respectively.

The weighted-average grant date fair value of SARs granted during the six months ended June 30, 2006 and 2005 was $2.70 and $4.18, respectively. The total intrinsic value of SARs that were exercised during the six months ended June 30, 2006 and 2005 was $0.9 million and $0.2 million, respectively.

As of June 30, 2006, there was $1.4 million of total unrecognized compensation cost related to SARs, which is expected to be recognized over a weighted-average period of one year.

***Stock Options***

PolyOne’s incentive stock plans provide for the award or grant of options to purchase shares of PolyOne common stock. Options granted generally become exercisable at the rate of 35% after one year, 70% after two years and 100% after three years. The term of each option cannot extend beyond 10 years from the date of grant. All options are granted at 100% or greater of market value on the date of the grant. PolyOne also has a stock option plan for non-employee directors under which options are granted.

A summary of option activity as of June 30, 2006 and changes during the six months then ended, is presented below:

| Stock Options | Shares (in thousands) | Weighted-Average Exercise Price | Weighted-Average Remaining Contractual Term | Aggregate Intrinsic Value (in millions) |
|---|---|---|---|---|
| Outstanding at January 1, 2006 | 9,115 | $ 11.55 | | |
| Granted | — | | | |
| Exercised | (394) | $ 6.81 | | |
| Forfeited or expired | (947) | $ 11.68 | | |
| Outstanding at June 30, 2006 | 7,774 | $ 11.76 | 3.17 years | $ 2.3 |
| Vested and exercisable at June 30, 2006 | 7,774 | $ 11.76 | 3.17 years | $ 2.3 |

The total intrinsic value of stock options that were exercised during the six months ended June 30, 2006 and 2005 was $0.8 million and $0.1 million, respectively.

Cash received during the first six months of 2006 and 2005 from the exercise of stock options was $2.8 million and $0.3 million, respectively.

***Performance Shares***

In January 2005, the Compensation and Governance Committee authorized the issuance of performance shares to selected executives and other key employees. 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. The fair value of each performance share is equal to the grant date market price.

At December 31, 2005, there were 587,202 performance share awards outstanding with a weighted-average fair value of $8.94 per share. During the first quarter of 2006, an additional 87,000 performance share awards were issued with a weighted-average fair value of $9.19 per share. For the six months ended June 30, 2006, compensation cost of $0.5 million was recognized for these awards. As of June 30, 2006, based on projected performance attainment for the remaining life of the awards, the unrecognized compensation cost of these awards was approximately $1.1 million.

***Restricted Stock Awards***

On February 21, 2006, PolyOne issued 200,000 shares of restricted stock as part of the compensation package for its new Chief Executive Officer. The value of the restricted shares was established using the market price of PolyOne’s common stock on the date of the grant. Compensation expense is being recorded on a straight-line basis over the three-year cliff restricted stock vesting period. As of June 30, 2006, all 200,000 shares remain unvested with a weighted-average grant date fair value of $8.84 per share and a weighted-average remaining contractual term of 32 months. Compensation expense recorded in the first six months of 2006 was $0.2 million. Unrecognized compensation cost for restricted stock awards at June 30, 2006 was $1.6 million.

**Note I — Earnings Per Share Computation**

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| (In millions) | 2006 | 2005 | 2006 | 2005 |
| Weighted-average shares outstanding — basic | 92.4 | 91.8 | 92.2 | 91.8 |
| Weighted-average shares — diluted: | | | | |
| Weighted-average shares outstanding — basic | 92.4 | 91.8 | 92.2 | 91.8 |
| Plus dilutive impact of stock options and stock awards | 0.6 | 0.3 | 0.4 | 0.3 |
| Weighted-average shares — diluted | 93.0 | 92.1 | 92.6 | 92.1 |

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

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Outstanding stock options with exercise prices greater than the average price of the common shares are anti-dilutive and are not included in the computation of diluted earnings per share. The number of anti-dilutive options and awards was 7.7 million at June 30, 2006 and 9.3 million at June 30, 2005.

**Note J — Employee Separation and Plant Phaseout**

Since the formation of PolyOne in 2000, management has undertaken several restructuring initiatives to improve profitability and, as a result, PolyOne has incurred employee separation and plant phaseout costs. For further discussion of these initiatives, see Note E to the Consolidated Financial Statements included in PolyOne's Annual Report on Form 10-K for the year ended December 31, 2005.

**2006 Charges —** Operating income for the six months ended June 30, 2006 includes a $0.5 million charge related to the closing of the Manchester, England color additives facility. During the first six months of 2006, two additional employees were affected by the closing and all 24 remaining employees were terminated.

During the six months ended June 30, 2006, PolyOne recognized a net benefit of $0.8 million, which was comprised of a gain on sale of its Burlington plant of $2.7 million, impairment charges of $2.2 million to write down to net realizable value two plants held for sale, and a net benefit of $0.3 million on the sale of its Yerrington engineered films facility and its Somerset color and additives facility.

The net benefit for the three months and six months ended June 30, 2006 of $0.2 million and $0.3 million, respectively, is included as a separate line item "Employee separation and plant phaseout" in the Condensed Consolidated Income Statement of Operations for the three months and six months ended June 30, 2006.

The following table summarizes the movement of the reserves associated with each of these initiatives from December 31, 2005 to June 30, 2006:

| (In millions, except employee numbers) | Employee Separation | | Plant Phaseout Costs | | |
|---|---|---|---|---|---|
| **Closure and exit of Manchester, England Color Additives facility** | **Number of Employees** | **Costs** | **Cash Closure** | **Asset Write-Downs** | **Total** |
| Balance at December 31, 2005 | 22 | $ — | $— | $— | $ — |
| Continuing operations charge | 2 | 0.5 | — | — | 0.5 |
| Utilized | (24) | (0.5) | — | — | (0.5) |
| Balance at June 30, 2006 | — | $ — | $— | $— | $ — |

| | Employee Separation | | Plant Phaseout Costs | | |
|---|---|---|---|---|---|
| **Executive severance** | **Number of Employees** | **Costs** | **Cash Closure** | **Asset Write-Downs** | **Total** |
| Balance at December 31, 2005 | — | $ 2.5 | $— | $— | $ 2.5 |
| Utilized | — | (0.7) | — | — | (0.7) |
| Balance at June 30, 2006 | — | $ 1.8 | $— | $— | $ 1.8 |

| | Employee Separation | | Plant Phaseout Costs | | |
|---|---|---|---|---|---|
| **Sale of previously closed facilities** | **Number of Employees** | **Costs** | **Cash Closure** | **Asset Write-Downs** | **Total** |
| Balance at December 31, 2005 | — | $— | $— | $ — | $ — |
| Continuing operations (benefit) | — | — | — | (0.8) | (0.8) |
| Utilized | — | — | — | 0.8 | 0.8 |
| Balance at June 30, 2006 | — | $— | $— | $ — | $ — |

| | Employee Separation | | Plant Phaseout Costs | | |
|---|---|---|---|---|---|
| **Total** | **Number of Employees** | **Costs** | **Cash Closure** | **Asset Write-Downs** | **Total** |
| Balance at December 31, 2005 | 22 | $ 2.5 | $— | $ — | $ 2.5 |
| Continuing operations charge (benefit) | 2 | 0.5 | — | (0.8) | (0.3) |
| Utilized | (24) | (1.2) | — | 0.8 | (0.4) |
| Balance at June 30, 2006 | — | $ 1.8 | $— | $ — | $ 1.8 |

**Note K — Employee Benefit Plans**

Components of defined benefit pension plan costs are as follows:

| (In millions) | Three Months Ended June 30, 2006 | Three Months Ended June 30, 2005 | Six Months Ended June 30, 2006 | Six Months Ended June 30, 2005 |
|---|---|---|---|---|
| Service cost | $ 0.4 | $ 0.2 | $ 0.7 | $ 0.4 |
| Interest cost | 7.4 | 7.1 | 14.9 | 14.2 |
| Expected return on plan assets | (7.5) | (7.8) | (15.1) | (15.5) |
| Amortization of unrecognized losses, transition obligation and prior service cost | 3.6 | 3.4 | 7.3 | 6.8 |
| | $ 3.9 | $ 2.9 | $ 7.8 | $ 5.9 |

No minimum pension funding payment is expected to be required in 2006.

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

| (In millions) | Three Months Ended June 30, 2006 | Three Months Ended June 30, 2005 | Six Months Ended June 30, 2006 | Six Months Ended June 30, 2005 |
|---|---|---|---|---|
| Service cost | $ 0.1 | $ 0.2 | $ 0.2 | $ 0.3 |
| Interest cost | 1.4 | 1.5 | 2.8 | 3.1 |
| Expected return on plan assets | — | — | — | — |
| Amortization of unrecognized losses, transition obligation and prior service cost | (0.9) | (0.7) | (1.8) | (1.3) |
| | $ 0.6 | $ 1.0 | $ 1.2 | $ 2.1 |

**Note L — Financing Arrangements**

PolyOne is exposed to market risk from changes in interest rates on debt obligations and from changes in foreign currency exchange rates. Information about these risks and exposure management is included in Item 7A "Qualitative and Quantitative Information about Market Risk" in PolyOne's Annual Report on Form 10-K for the year ended December 31, 2005. PolyOne periodically enters into interest rate swap agreements that modify its exposure to interest rate risk by converting fixed-rate obligations to floating rates. PolyOne maintained interest rate swap agreements on six of its fixed-rate obligations in the aggregate amount of $100.0 million at June 30, 2006. These exchange agreements are "perfectly effective" as defined by SFAS No. 133, "Accounting for Derivative Financial Instruments and Hedging Activities." At June 30, 2006, these agreements had a net fair value obligation of $7.2 million. The weighted-average interest rate for these six agreements was 9.0%. There have been no material changes in the market risk faced by PolyOne from December 31, 2005 to June 30, 2006.

In June 2006, PolyOne repurchased $15.0 million aggregate principal amount of its 10.625% senior notes at a premium of $1.2 million. The premium is shown as a separate line item in the Condensed Consolidated Statements of Operations. Unamortized deferred note issuance costs of $0.2 million were expensed due to this repurchase and are included in interest expense in the Condensed Consolidated Statements of Operations.

**Note M — Sale of Accounts Receivable**

Accounts receivable consist of the following:

| (In millions) | June 30, 2006 | December 31, 2005 |
|---|---|---|
| Trade accounts receivable | $ 177.8 | $ 139.6 |
| Retained interest in securitized accounts receivable | 208.6 | 187.3 |
| Allowance for doubtful accounts | (6.5) | (6.4) |
| | $ 379.9 | $ 320.5 |

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 June 30, 2006, accounts receivable totaling $208.6 million were sold by PolyOne to PFC. PFC in turn may sell an undivided interest in these accounts receivable to certain investors and realize proceeds of up to $175 million. The maximum amount of proceeds that PFC may receive under the facility is limited to 85% of the eligible accounts receivable that are sold to PFC. At June 30, 2006, PFC had not sold any of its undivided interests in accounts receivable, compared with $7.9 million at December 31, 2005. PolyOne retained an interest in the $208.6 million difference between the amount of trade receivables sold by PolyOne to PFC and the undivided interests sold by PFC as of June 30, 2006. As a result, this interest retained by PolyOne is included in accounts receivable on the Condensed Consolidated Balance Sheet at June 30, 2006.

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 facility, of which $11.7 was used at June 30, 2006. Continued availability of the receivables sale facility depends upon compliance with a fixed charge coverage ratio covenant related primarily to operating performance that is set forth in the related agreements. As of June 30, 2006, PolyOne was in compliance with this covenant.

**Note N — Segment Information**

PolyOne manages its business in three reportable segments: Performance Plastics, Distribution, and Resin and Intermediates. The accounting policies of each segment are consistent with those described in “Summary of Significant Accounting Policies” in Note C to the Consolidated Financial Statements included in PolyOne’s Annual Report on Form 10-K for the year ended December 31, 2005. Segment assets are primarily customer receivables, inventories, net property 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 and liabilities.

| Six months ended June 30, 2006 (in millions) | Total | Performance Plastics | Distribution | Resin and Intermediates | Other |
|---|---|---|---|---|---|
| Sales to external customers | $ 1,361.0 | $ 982.0 | $ 379.0 | $ — | $ — |
| Intersegment eliminations | — | 75.8 | 4.8 | — | (80.6) |
| | $ 1,361.0 | $ 1,057.8 | $ 383.8 | $ — | $ (80.6) |
| Operating income (loss) | $ 131.4 | $ 56.4 | $ 11.3 | $ 65.1 | $ (1.4) |
| Depreciation and amortization | $ 28.6 | $ 25.7 | $ 0.7 | $ 0.1 | $ 2.1 |
| Total assets | $ 1,835.9 | $ 1,198.7 | $ 188.2 | $ 286.5 | $ 162.5 |
| Capital expenditures | $ 12.5 | $ 10.1 | $ 0.1 | $ — | $ 2.3 |

| Six months ended June 30, 2005 (in millions) | Total | Performance Plastics | Distribution | Resin and Intermediates | Other |
|---|---|---|---|---|---|
| Sales to external customers | $ 1,232.2 | $ 898.4 | $ 333.8 | $ — | $ — |
| Intersegment eliminations | — | 71.5 | 3.9 | — | (75.4) |
| | $ 1,232.2 | $ 969.9 | $ 337.7 | $ — | $ (75.4) |
| Operating income (loss) | $ 97.9 | $ 43.5 | $ 9.4 | $ 51.4 | $ (6.4) |
| Depreciation and amortization | $ 24.9 | $ 23.1 | $ 0.7 | $ 0.1 | $ 1.0 |
| Total assets | $ 1,778.1 | $ 1,177.0 | $ 168.3 | $ 293.4 | $ 139.4 |
| Capital expenditures | $ 18.8 | $ 14.5 | $ 0.2 | $ — | $ 4.1 |

| Three months ended June 30, 2006 (in millions) | Total | Performance Plastics | Distribution | Resin and Intermediates | Other |
|---|---|---|---|---|---|
| Sales to external customers | $ 686.4 | $ 498.7 | $ 187.7 | $ — | $ — |
| Intersegment eliminations | — | 38.9 | 2.0 | — | (40.9) |
| | $ 686.4 | $ 537.6 | $ 189.7 | $ — | $ (40.9) |
| Operating income (loss) | $ 63.5 | $ 28.7 | $ 5.1 | $ 28.9 | $ 0.8 |
| Depreciation and amortization | $ 14.3 | $ 12.9 | $ 0.3 | $ — | $ 1.1 |
| Capital expenditures | $ 7.6 | $ 5.9 | $ 0.1 | $ — | $ 1.6 |

| Three months ended June 30, 2005 (in millions) | Total | Performance Plastics | Distribution | Resin and Intermediates | Other |
|---|---|---|---|---|---|
| Sales to external customers | $ 620.4 | $ 452.0 | $ 168.4 | $ — | $ — |
| Intersegment eliminations | — | 33.7 | 1.8 | — | (35.5) |
| | $ 620.4 | $ 485.7 | $ 170.2 | $ — | $ (35.5) |
| Operating income (loss) | $ 53.2 | $ 26.2 | $ 4.0 | $ 28.5 | $ (5.5) |
| Depreciation and amortization | $ 12.4 | $ 11.6 | $ 0.3 | $ 0.1 | $ 0.4 |
| Capital expenditures | $ 9.9 | $ 7.5 | $ — | $ — | $ 2.4 |

**Note O — Commitments and Contingencies**

PolyOne has been notified by certain federal and state environmental agencies and by private parties that it may be a potentially responsible party (PRP) in connection with the investigation and remediation of several environmental waste disposal sites. While government agencies frequently assert that PRPs are

jointly and severally liable at these sites, in PolyOne's experience, the interim and final allocations of liability costs are generally made based on the relative contribution of waste. PolyOne believes that its potential continuing liability with respect to these sites will not have a material adverse effect on its consolidated financial position, results of operations or cash flows. In addition, PolyOne initiates corrective and preventive environmental projects of its own to ensure safe and lawful activities at its operations. PolyOne believes that compliance with current governmental regulations at all levels will not have a material adverse effect on its financial condition. Based on estimates that were prepared by its environmental engineers and consultants, PolyOne had accruals totaling $56.3 million at June 30, 2006 and $55.2 million at December 31, 2005 to cover probable future environmental expenditures related to previously contaminated sites. The accrual represents PolyOne's best estimate of the remaining probable remediation costs, based upon information and technology that is currently available and PolyOne's view of the most likely remedy. Depending upon the results of future testing, the ultimate remediation alternatives undertaken, changes in regulations, new information, newly discovered conditions and other factors, it is reasonably possible that PolyOne could incur additional costs in excess of the amount accrued at June 30, 2006. However, such additional costs, if any, cannot be currently estimated. PolyOne's estimate of the liability may be revised as new regulations or technologies are developed or additional information is obtained. PolyOne incurred environmental expense of $4.1 million at its active and inactive sites in the first six months of 2006, offset by insurance proceeds of $7.5 million that were received during the same period. For the first six months of 2005, PolyOne recorded no expense related to environmental activities and received no proceeds from insurance recoveries. Additional information related to environmental liabilities is in Note N to the Consolidated Financial Statements included in PolyOne's Annual Report on Form 10-K for the year ended December 31, 2005.

Included in the first six months of 2006 and 2005 was a net benefit of $14.8 million and $5.0 million, respectively, and included in three months ended June 30, 2006 and 2005, was a benefit of $6.1 million and $1.3 million, respectively, from the combined effect of settlements of legal disputes and adjustments to litigation reserves.

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 matures in 2017.

## Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

### Overview

We are a leading global provider of specialized polymer materials, services and solutions with operations in thermoplastic compounds, specialty vinyl resins, specialty polymer formulations, color and additive systems, and thermoplastic resin distribution and with equity investments in manufacturers of PVC resin and its intermediates. Headquartered in Avon Lake, Ohio, we have employees at manufacturing sites and warehouses in North America, Europe and Asia, and joint ventures in North America and Colombia. 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 and designers, assemblers and processors of plastics.

***Discontinued Operations —*** We sold 82% of our Engineered Films business in the first quarter of 2006 and retained an 18% ownership interest. This retained interest is being reported on the cost method of accounting. All historical financial information for the Engineered Films business, for periods prior to the sale, has been accounted for as a discontinued operation and is summarized in the following table:

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| (In millions) | 2006 | 2005 | 2006 | 2005 |
| Sales | $ — | $ 31.1 | $ 9.6 | $ 61.1 |
| Pre-tax income (loss) from operations: | $ — | $ (1.7) | $ 0.2 | $ (1.7) |
| Pre-tax loss on disposition of business: | — | — | (2.3) | (11.6) |
| Income tax expense (net of valuation allowance) | — | — | — | — |
| Loss from discontinued operations | $ — | $ (1.7) | $ (2.1) | $ (13.3) |

***Outlook —*** We are cautious about third-quarter demand within Performance Plastics due to a forecasted slowing in the North American automotive and building products markets. However, our view is that sales and shipments should approximate second quarter 2006 levels. Operating income is projected to improve compared with the 2005 third-quarter but is likely to decline compared to 2006 second-quarter performance as operating margins are anticipated to come under pressure as energy derived raw materials increase.

The Distribution segment sales and shipment levels are projected to be slightly lower than second-quarter 2006 levels but improve compared with the third quarter of 2005. Third quarter 2006 operating income is projected to decline sequentially but approximate third quarter 2005 performance.

We project that the Resin and Intermediates segment will continue to deliver strong earnings in the third quarter. Earnings for both OxyVinyls and SunBelt are expected to be significantly improved compared to the third quarter of 2005, but trend lower sequentially. Both businesses would be adversely affected by lower caustic demand and pricing. Additionally, industry PVC resin product spreads are projected to narrow as announced PVC price hikes may lag the realized and announced ethylene cost increases. Energy costs are anticipated to move upwards during the quarter as well.

We currently anticipate that we could benefit again from legal settlements in the third quarter of 2006. While the impact is difficult to predict, we project the benefit in the third quarter could approach the benefit realized in the second quarter of 2006.

Considering all of these factors, we project that earnings during the third quarter should improve compared to the same period in 2005 but decline sequentially.

**Results of Operations**

Income from continuing operations for the second quarter of 2006 improved by $9.4 million, or $0.10 per diluted share, from the second quarter of 2005, and for the first six months of 2006 by $33.3 million, or $0.36 per diluted share, from the first six months of 2005. Sales increased by 11% in the second quarter and by 10% for the first six months of 2006 from the same periods last year due to volume improvements in both our Performance Plastics and our Distribution segments from stronger demand in most customer end markets, increased market penetration in Asia that was supported by our new manufacturing facility in China, and new business. The sales increase was also driven by higher selling prices that were required to offset escalating raw material and energy costs. Improved earnings were primarily the result of improved volume, margin expansion that began in the second half of last year as we increased selling prices in a high raw material and energy cost escalation environment, and strong earnings from our equity affiliates.

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| (In millions) | 2006 | 2005 | 2006 | 2005 |
| **Sales:** | | | | |
| Performance Plastics segment | $ 537.6 | $ 485.7 | $ 1,057.8 | $ 969.9 |
| Distribution segment | 189.7 | 170.2 | 383.8 | 337.7 |
| Intersegment eliminations | (40.9) | (35.5) | (80.6) | (75.4) |
| Total sales | $ 686.4 | $ 620.4 | $ 1,361.0 | $ 1,232.2 |
| **Net income (loss):** | | | | |
| Performance Plastics segment | $ 28.7 | $ 26.2 | $ 56.4 | $ 43.5 |
| Distribution segment | 5.1 | 4.0 | 11.3 | 9.4 |
| Resin and Intermediates segment | 28.9 | 28.5 | 65.1 | 51.4 |
| Other segment | 0.8 | (5.5) | (1.4) | (6.4) |
| Operating income | 63.5 | 53.2 | 131.4 | 97.9 |
| Interest expense, net | (17.2) | (17.0) | (33.3) | (33.3) |
| Other expense, net | (1.5) | (0.8) | (2.7) | (1.6) |
| Income before income taxes and discontinued operations | 44.8 | 35.4 | 95.4 | 63.0 |
| Income tax expense | (2.4) | (2.4) | (4.1) | (5.0) |
| Income from continuing operations | 42.4 | 33.0 | 91.3 | 58.0 |
| Loss from discontinued operations, net of taxes | — | (1.7) | (2.1) | (13.3) |
| Net income | $ 42.4 | $ 31.3 | $ 89.2 | $ 44.7 |

Period to period changes in sales and operating income are discussed in the following "Business Segment Information" section. We also discuss the results of our reporting segments in Note N to the Condensed Consolidated Financial Statements.

***Selected Operating Costs:***

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| Cost of sales | 86.4% | 86.8% | 86.4% | 87.0% |
| Selling and administrative | 7.3% | 7.7% | 7.3% | 7.7% |

***Cost of Sales*** — These costs, as a percentage of sales, declined in 2006 primarily from successful efforts to increase our selling prices during 2005 to pass on higher raw material, distribution and energy costs.

***Selling and Administrative*** - In 2006, we had higher share-based compensation costs from adopting SFAS No. 123(R), one-time executive recruiting and hiring costs, and higher employee compensation and benefit costs, a portion of which resulted from higher earnings levels. We also settled various legal disputes in our favor in 2005 and 2006, resulting in the receipt of cash payments or adjustments to the associated reserves on our books. The net impact of these items was additional expense of $3.5 million in the second quarter of 2006 compared with the second quarter of 2005, and additional expense of $2.5 million in the first half of 2006 compared with the first half of 2005. The remainder of the change in selling and administrative expenses as a percentage of sales in 2006 was primarily the result of higher sales levels in 2006.

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

Following are discussions of significant components of income and expense that are presented below the line "Operating income" in the Condensed Consolidated Statements of Operations.

***Interest expense, net*** — The change in interest expense in 2006 compared with 2005 was due to lower average debt levels, offset by a premium of $1.2 million paid on early extinguishment of long-term debt in the second quarter of 2006. As of June 30, 2006, debt was $627.6 million, which was $18.9 million lower than debt as of December 31, 2005 and $63.9 million lower than debt as of June 30, 2005.

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| (In millions) | 2006 | 2005 | 2006 | 2005 |
| Currency exchange gain (loss), net of foreign exchange contracts | $ (0.8) | $ 2.0 | $ (1.0) | $ 2.6 |
| Discount on sale of trade receivables | (0.5) | (2.3) | (1.3) | (3.5) |
| Retained post-employment benefit cost related to previously discontinued business operations | — | (0.3) | — | (0.6) |
| Other income (loss), net | (0.2) | (0.2) | (0.4) | (0.1) |
| | $ (1.5) | $ (0.8) | $ (2.7) | $ (1.6) |

***Income taxes*** — Income tax expense for the three months ended June 30, 2006 and 2005 was $2.4 million. For the six months ended June 30, 2006 and 2005, income tax expense was $4.1 million and $5.0 million, respectively. The effective tax rate for each period presented was lower than the federal statutory rate due to the utilization of net operating loss carryforwards for which allowances had been previously provided. For the second quarter and first half of 2006, a tax provision was recorded for federal alternative minimum tax, various state income taxes and foreign taxes. A domestic tax provision was not applied against income before income taxes in either the second quarter or the first half of 2005. Tax expense for 2005 represents foreign taxes. In accordance with SFAS No. 109, "Accounting for Income Taxes," due to uncertainty regarding the full utilization of our deferred income taxes, we intend to maintain the valuation allowance until additional realization events occur, including the generation of future sustainable taxable income, that would support reversal of all or a portion of the allowance. Tax expense for each period primarily represents foreign, state and local taxes, while tax expense for the second quarter and first half of 2006 also includes $0.3 million and $0.5 million, respectively, for federal alternative minimum taxes.

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**Business Segment Information**

| (In millions) | Three Months Ended June 30, 2006 | 2005 | Change | % Change | Six Months Ended June 30, 2006 | 2005 | Change | % Change |
|---|---|---|---|---|---|---|---|---|
| Sales: | | | | | | | | |
| Performance Plastics segment | $ 537.6 | $ 485.7 | $ 51.9 | 11% | $ 1,057.8 | $ 969.9 | $ 87.9 | 9% |
| Distribution segment | 189.7 | 170.2 | 19.5 | 11% | 383.8 | 337.7 | 46.1 | 14% |
| Intersegment eliminations | (40.9) | (35.5) | (5.4) | 15% | (80.6) | (75.4) | (5.2) | 7% |
| | $ 686.4 | $ 620.4 | $ 66.0 | 11% | $ 1,361.0 | $ 1,232.2 | $ 128.8 | 10% |
| Operating income (loss): | | | | | | | | |
| Performance Plastics segment | $ 28.7 | $ 26.2 | $ 2.5 | 10% | $ 56.4 | $ 43.5 | $ 12.9 | 30% |
| Distribution segment | 5.1 | 4.0 | 1.1 | 28% | 11.3 | 9.4 | 1.9 | 20% |
| Resin and Intermediates segment | 28.9 | 28.5 | 0.4 | 1% | 65.1 | 51.4 | 13.7 | 27% |
| Other segment | 0.8 | (5.5) | 6.3 | (115%) | (1.4) | (6.4) | 5.0 | (78%) |
| | $ 63.5 | $ 53.2 | $ 10.3 | 19% | $ 131.4 | $ 97.9 | $ 33.5 | 34% |
| Volume (pounds): | | | | | | | | |
| Performance Plastics segment | 582.2 | 550.0 | 32.2 | 6% | 1,141.0 | 1,110.2 | 30.8 | 3% |
| Distribution segment | 169.2 | 159.9 | 9.3 | 6% | 341.5 | 322.7 | 18.8 | 6% |

Performance Plastics' volume was 6% higher in the second quarter of 2006 and 3% higher in the first six months of 2006 than in the same periods in 2005. For both the second quarter and first six months of 2006, we saw stronger demand in most customer end-markets, combined with new business closes and the introduction of new products into the global market place. Domestic end-market demand was especially evident in custom injection molding, packaging, screen printing, and piping-related products from customers in the natural gas and petroleum distribution markets. This volume uplift was partially offset, however, by a decline in demand from automotive customers that resulted from reduced production schedules and platform build-outs. Volume improvements were also seen in Europe and Asia. In Europe, we realized the benefits from regaining share lost in 2004 and 2005 and from general economic improvement in key economies. In Asia, volume growth reflected new application developments, share gains and a general strengthening in the Asian economies, supported by our new manufacturing facility in south China.

The increase in Performance Plastics' sales of 11% for the second quarter and 9% for the first six months of 2006 compared with the comparable periods in the prior year was driven by higher volumes combined with higher average selling prices that recovered increases in raw material, distribution and energy costs. Lower average currency exchange rates in the first half of 2006 compared with the same period in the previous year, primarily during the first quarter, negatively impacted the year-over-year sales comparison by $9.5 million. Average exchange rates in the second quarter of 2006 were slightly higher than the second quarter of 2005, positively impacting the year-over-year sales comparison by $0.4 million. Performance Plastics' operating income improvement in the first half of 2006 was the result of higher volume, combined with margin improvements from the below cycle average margins we saw in 2005, partially offset by higher employee compensation and benefit costs. Differences in average currency exchange rates negatively impacted operating income by $0.4 million for the first six months of 2006 and by $0.1 million for the second quarter of 2006 compared to the same periods in 2005.

Distribution's second quarter and first half of 2006 volume was up 6% from the same periods in 2005 due to higher demand in most customer end-markets combined with gains in market share. The revenue increases were driven by higher volume combined with selling price increases that were passed through from our supplier base. Operating income improved primarily as a result of higher volume, but was partially offset by higher energy-related distribution costs and employee compensation and benefit costs.

Resin and Intermediates' first half 2006 operating income was up $13.7 million from the first half of 2005, while second quarter 2006 operating income was up $0.4 million from the same period in 2005. The first half of 2006 improvement reflects $6.1 million higher OxyVinyls equity earnings and $6.8 million higher SunBelt equity earnings. In the second quarter of 2006, OxyVinyls' equity earnings declined $3.4 million compared to the second quarter of 2005, while SunBelt's equity earnings were up $3.3 million. OxyVinyls' first half of 2006 earnings improvement resulted from higher industry average PVC resin and vinyl chloride monomer price spreads over raw material costs. OxyVinyls' second quarter 2006 earnings were negatively impacted by lower volumes, increases in conversion and energy costs, and a disruption to operations caused by power outages in April 2006. These factors in combination were, however, partially offset by a gain on the sale of idled assets that OxyVinyls sold in June 2006. SunBelt's earnings improvement was due to higher combined selling prices for chlorine and caustic soda, driven by strong demand.

"Other" consists primarily of corporate general and administrative costs that were not allocated to business segments and inter-segment sales and profit eliminations.

**Critical Accounting Policies and Estimates**

The preparation of financial statements in conformity with generally accepted accounting principles requires management 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. As a result, actual results could differ significantly from these estimates. A description of these accounting policies and estimates is included in Item 7 "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Annual Report on Form 10-K for the year ended December 31, 2005. For additional information regarding our accounting policies, see Note C to the Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2005.

***Share-Based Compensation* —** Prior to January 1, 2006, as permitted under SFAS No. 123, we applied APB No. 25 and related interpretations to account for our share-based compensation plans. Under APB No. 25, compensation expense was recognized for stock option grants if the exercise price of the grant was below the fair value of the underlying stock at the measurement date. On January 1, 2006, we adopted SFAS No. 123(R), which requires us to recognize compensation expense based on the fair value on the date of the grant. We are using the modified prospective transition method, which does not require prior period financial statements to be restated. The impact on pre-tax earnings for the three-month periods ended March 31, 2006 and June 30, 2006 was a charge of $1.4 million and $0.8 million, respectively, from adopting SFAS No. 123(R). The charge to pre-tax earnings in the second half of 2006 is expected to be approximately $0.9 million per quarter.

The option pricing model we used was a Monte Carlo simulation method to value the stock appreciation rights granted during the first quarter of 2006. Under this method, the fair value of awards on the date of grant is an estimate and is affected by our stock price, as well as assumptions regarding a number of highly complex and subjective variables. Expected volatility was set at the average of the six-year historical weekly volatility for our common stock and the implied volatility rates for exchange traded options. The expected term of options granted was set equal to halfway between the vesting and expiration dates for each grant. Dividends were not included in this calculation because we do not currently pay dividends. The risk-free rate of return for periods within the contractual life of the option is based on U.S. Treasury rates in effect at the time of the grant. Forfeitures were estimated at 3% per year based on our historical experience.

For more information on the adoption and impact of SFAS No. 123(R), see Note C and Note H to the Condensed Consolidated Financial Statements.

***Goodwill —*** As of June 30, 2006, we had $315.3 million of goodwill that resulted from the acquiring businesses. SFAS No. 142, "Goodwill and Other Intangible Assets," requires us to perform impairment tests of our goodwill at least once a year, or more frequently if an event or circumstance indicates that an impairment or decline in value may have occurred. To make this impairment assessment, we compare the fair value of each of our reporting units with that reporting unit's carrying value. If the fair value of the reporting unit exceeds its carrying value, goodwill is considered not to be impaired. If the carrying value of a reporting unit exceeds its fair value, an impairment loss is measured and recognized. We have selected July 1 as our annual impairment testing date.

We determined that goodwill was not impaired when we performed our last annual assessment as of July 1, 2005. As of June 30, 2006, no potential indicator of impairment exists, such as a significant adverse change in legal factors or business climate, an adverse action or assessment by a regulator, unanticipated competition, loss of key personnel or a more-likely-than-not expectation that a reporting unit or a significant portion of a reporting unit will be sold or disposed. Based upon this, we concluded that an interim assessment as of June 30, 2006 was not required.

**Cash Flows**

Detail about cash flows is contained in the Condensed Consolidated Statement of Cash Flows. The following discussion focuses on material components of cash flows from operating, investing and financing activities from the end of the preceding fiscal year (December 31, 2005) to the date of the most recent interim balance sheet (June 30, 2006).

***Operating Activities —*** Our operations provided $46.2 million of cash in the first six months of 2006. Primary sources of cash were net income of $89.2 million, dividends and distributions received from equity affiliates of $42.2 million and a $31.7 million increase in accounts payable mainly due to higher purchasing levels in support of higher production levels at the end of the second quarter compared to the previous year end. Primary uses of cash were a $43.4 million increase in accounts receivable due to higher sales levels at the end of the second quarter compared to the previous year end that was partially offset by an improvement in average days outstanding, a $16.4 million increase in inventories due to higher production levels at the end of the second quarter compared to the previous year end that was partially offset by improved inventory turnover efficiency, and the repayment of $7.9 million of short-term borrowings under our receivables sale facility.

In addition, income from our equity affiliates exceeded the cash dividends and distributions that we received by $27.9 million, and the decline in other current assets of $9.2 million was due to the receipt of legal settlement payments that we had accrued at December 31, 2005.

***Working capital management***

Our working capital management efforts focus on three components of working capital that we believe are the most vital 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 these components, we use metrics that measure the number of days of sales in receivables (DSO), days of sales in inventories (DSI), and days of sales in accounts payable (DSP). This allows us to better understand the total dollar changes in these working capital components by separating 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. Under these measurements, higher sales and production levels would have consumed approximately $60.2 million in cash to fund the growth in these three components. More efficient management of these components, however, reduced the amount of cash that was required to $28.1 million.

| | June 30, 2006 | December 31, 2005 |
|---|---|---|
| Accounts receivable DSO | 48.0 | 51.1 |
| Inventories DSI | 38.7 | 42.2 |
| Accounts payable DSP | (39.8) | (41.2) |
| Net days outstanding at end of the period | 46.9 | 52.1 |
| Change in net days from prior period | (5.2) | |
| Cash provided (used) by: | | |
| (In millions) | | |
| Accounts receivable | $(43.4) | |
| Inventories | (16.4) | |
| Accounts payable | 31.7 | |
| | $(28.1) | |
| Impact of change in net days outstanding | $ 32.1 | |
| Impact of change in sales and production levels | (60.2) | |
| | $(28.1) | |

***Investing activities —*** Cash provided by investing activities in the first six months of 2006 was $11.8 million. Net proceeds of $17.3 million received from the sale of the Engineered Films business and $7.2 million from the sale of other assets was partially offset by $12.5 million of capital expenditures in support of our manufacturing operations. Capital spending was 45% of depreciation expense for the period.

***Financing activities —*** Cash used by financing activities in the first six months of 2006 totaled $16.6 million, the result of debt repayments of $19.4 million that were partially offset by $2.8 million we received from the exercise of stock options by employees.

***Discontinued Operations*** — Cash flows from discontinued operations are presented separately on a single line in each section of the Consolidated Statement of Cash Flows. With the sale of the Engineered Films business in February 2006, we no longer have any businesses accounted for as discontinued operations.

**Capital Resources and Liquidity**

As of June 30, 2006, we had $75.0 million in cash and cash equivalents along with existing facilities to access available capital resources (receivables sale facility, uncommitted short-term credit lines and senior unsecured notes and debentures) totaling $767.9 million. As of June 30, 2006, we had used $627.6 million of these facilities, and $140.3 million was available to be drawn while remaining in compliance with our covenants. In addition, at June 30, 2006, we could incur additional secured debt in an amount up to $31.7 million while remaining in compliance with the debt coverage limit contained in the Guarantee and Agreement, discussed in the section titled “Revolving Credit Facility” below.

The following table summarizes our outstanding and available facilities at June 30, 2006:

| (In millions) | Outstanding | Available |
|---|---|---|
| Long-term debt | $ 623.0 | $ — |
| Receivables sale facility | — | 140.3 |
| Short-term bank debt | 4.6 | — |
| | $ 627.6 | $ 140.3 |

***Long-term Debt —*** At June 30, 2006, we had long-term debt of $623.0 million, with maturities through 2015. Current maturities of long-term debt at June 30, 2006 were $19.3 million. In June 2006, we repurchased $15.0 million aggregate principal amount of our 10.625% senior notes at a premium. The premium of $1.2 million is shown as a separate line item in the Condensed Consolidated Statements of Operations. In addition, unamortized deferred note issuance costs of $0.2 million were expensed due to this debt repurchase and are included in interest expense in the Condensed Consolidated Statements of Operations.

***Revolving Credit Facility —*** We opted not to renew our revolving credit facility, and, accordingly, it expired on June 6, 2006. To replace some of the features of this expired facility, we entered into a definitive Guarantee and Agreement with Citicorp USA, Inc. on June 6, 2006. Under this Guarantee and Agreement, we guarantee the treasury management and banking services provided to us and our subsidiaries, such as subsidiary borrowings, interest rate swaps, foreign currency forwards, letters of credit, credit card programs and bank overdrafts. This guarantee is secured by our inventories located in the United States.

***Receivables Sale Facility —*** The receivables sale facility expires in July 2010. This facility allows us to sell accounts receivable and obtain proceeds of up to $175.0 million. The maximum amount that we may receive is limited to 85% of our eligible domestic accounts receivable sold. This facility also makes up to $40.0 million available for issuing standby letters of credit, of which $11.7 million was used at June 30, 2006. The facility requires us to maintain a minimum fixed charge coverage ratio (defined as Adjusted EBITDA less capital expenditures, divided by interest expense and scheduled debt repayments for the next four quarters) of at least 1 to 1 when availability under the facility is $40 million or less. As of June 30, 2006, the fixed charge coverage ratio was 2.3 to 1 and availability under the facility was $140.3 million.

Of the capital resource facilities available to us as of June 30, 2006, the portion of the receivables sale facility that we 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 June 30, 2006, we had not sold any accounts receivable and had guaranteed $73.1 million of SunBelt’s debt.

We expect that continuing profitable operations in the remainder of 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, ongoing working capital efficiency improvements, cash distributions from our equity affiliates, proceeds from settling legal disputes and borrowings under existing loan agreements. Expected uses of cash in 2006 include interest expense and discounts on the sale of accounts receivable, cash taxes, spending for previously announced restructuring initiatives and capital expenditures. Capital expenditures for 2006 are currently estimated between $45 million and $50 million primarily for

equipment to support our manufacturing operations. We may also continue to repurchase or repay additional long-term debt in 2006 as part of our overall 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 the receivables sale facility, should allow us to maintain adequate levels of available capital resources to fund our operations and meet debt service and minimum pension funding requirements for both the short- and long-term.

**Cautionary Note on Forward-Looking Statements**

In this quarterly report on Form 10-Q, statements that are not reported financial results or other historical information are “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements give current expectations or forecasts of future events and are not guarantees of future performance. They are based on management’s expectations that involve a number of business risks and uncertainties, any of which could cause actual results to differ materially from those expressed in or implied by the forward-looking statements. 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 polyvinyl chloride (PVC), chlor-alkali, vinyl chloride monomer (VCM) or other industries in which PolyOne participates;
- fluctuations in raw material prices, quality and supply and in energy prices and supply, in particular fluctuations outside the normal range of industry cycles;
- 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;
- an inability to access 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 our pension plan assets and any obligation on our part to fund PolyOne’s pension plan;
- any delay and/or inability to bring the North American Color and Additives Masterbatch and the Engineered Materials product groups to profitability;
- an inability to raise prices or sustain price increases for products;
- the occurrence and timing of any benefits from legal settlements or adjustments to litigation reserves;
- an inability to maintain appropriate relations with unions and employees in certain locations in order to avoid disruptions of business; and
- other factors affecting our business beyond our control, including, without limitation, changes in the general economy, changes in interest rates and changes in the rate of inflation.

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

We undertake no obligation to publicly update forward-looking statements, whether as a result of new information, future events or otherwise. You are advised, however, to consult any further disclosures we make on related subjects in our reports on Forms 10-Q, 8-K and 10-K furnished to the SEC. You should understand that it is not possible to predict or identify all risk factors. Consequently, you should not consider any such list to be a complete set of all potential risks or uncertainties.

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

PolyOne is exposed to market risk from changes in interest rates on debt obligations and from changes in foreign currency exchange rates. Information related to these risks and our management of the exposure is included in Item 7A “Qualitative and Quantitative Information about Market Risk” in PolyOne’s Annual Report on Form 10-K for the year ended December 31, 2005. PolyOne periodically enters into interest rate swap agreements that convert fixed-rate obligations to floating rates. PolyOne maintained interest rate swap agreements on six of its fixed-rate obligations in the aggregate amount of $100.0 million at January 1, 2006. These exchange agreements are “perfectly effective” as defined by SFAS No. 133, “Accounting for Derivative Financial Instruments and Hedging Activities.” At June 30, 2006, the six agreements had a net fair value obligation of $7.2 million. The weighted-average interest rate for these six agreements was 9.0%. There have been no material changes in the market risk faced by the Company from December 31, 2005 to June 30, 2006. We have updated the disclosure concerning our financing arrangements, which is included in Note L to the Condensed Consolidated Financial Statements included in this quarterly report.

**Item 4. Controls and Procedures**

Our management, under the supervision of and with the participation of our Chief Executive Officer and the Chief Financial Officer, has evaluated the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act, as of the end of the period covered by this quarterly report. Based upon this evaluation, our Chief

Executive Officer and Chief Financial Officer have concluded that, as of the end of the period covered by this quarterly report, PolyOne’s disclosure controls and procedures were effective.

There were no changes made in our internal control over financial reporting during the quarter ended June 30, 2006 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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## Part II — Other Information

### Item 1A. Risk Factors

There have been no material changes to the risk factors that are included in our Annual Report on Form 10-K for the year ended December 31, 2005 that could affect our business, results of operations or financial condition.

### Item 4. Submission of Matters to a Vote of Security Holders

PolyOne held its Annual Meeting of Stockholders on May 25, 2006. At the Annual Meeting, the following actions were taken:

a) The nine nominees for director were elected by the following vote:

| | Number of Shares Voted For | Number of Shares Withheld |
|---|---|---|
| J. Douglas Campbell | 86,932,214 | 1,050,788 |
| Carol A. Cartwright | 86,905,612 | 1,077,390 |
| Gale Duff-Bloom | 86,893,699 | 1,089,303 |
| Wayne R. Embry | 86,885,724 | 1,097,278 |
| Richard H. Fearon | 87,381,385 | 601,617 |
| Robert A. Garda | 87,358,290 | 624,712 |
| Gordon D. Harnett | 87,336,755 | 646,247 |
| Stephen D. Newlin | 86,989,977 | 993,025 |
| Farah M. Walters | 87,323,301 | 659,701 |

(b) Ratification of the appointment of Ernst & Young LLP as PolyOne Corporation's independent registered public accounting firm for the fiscal year ending December 31, 2006 received the following number of votes:

| For | Against | Abstain | Broker Non-Votes |
|---|---|---|---|
| 86,793,820 | 839,608 | 349,574 | — |

### Item 6. Exhibits

| Exhibit No. Under Reg. S-K Item 601 | Form 10-Q Exhibit No. | Description of Exhibit |
|---|---|---|
| (10) | 10.1 | Guarantee and Agreement, dated as of June 6, 2006, between PolyOne, as guarantor, and the beneficiary banks party thereto, incorporated by reference to the corresponding exhibit filed with PolyOne's Form 8-K on June 8, 2006 (SEC file No. 1-16091) |
| (10) | 10.2 | Second Amended and Restated Security Agreement, dated as of June 6, 2006, between PolyOne, as grantor, and U.S. Bank Trust National Association, as collateral trustee, incorporated by reference to the corresponding exhibit filed with PolyOne's Form 8-K on June 8, 2006 (SEC file No. 1-16091) |

| Exhibit No. Under Reg. S-K Item 601 | Form 10-Q Exhibit No. | Description of Exhibit |
|---|---|---|
| (10) | 10.3 | Amended and Restated Collateral Trust Agreement, dated as of June 6, 2006, between PolyOne, as grantor, and U.S. Bank Trust National Association, as collateral trustee, incorporated by reference to the corresponding exhibit filed with PolyOne’s Form 8-K on June 8, 2006 (SEC file No. 1-16091) |
| (10) | 10.4 | Amended and Restated Intercreditor Agreement, dated as of June 6, 2006, between PolyOne, as grantor, and Citicorp USA, Inc., as bank agent, U.S. Bank Trust National Association, as collateral trustee, and PolyOne Funding Corporation, incorporated by reference to the corresponding exhibit filed with PolyOne’s Form 8-K on June 8, 2006 (SEC file No. 1-16091) |
| (10)+ | 10.5 | Form of Director and Officer Indemnification Agreement, incorporated by reference to the corresponding exhibit filed with PolyOne’s Form 8-K on July 5, 2006 (SEC file No. 1-16091) |
| (10)+ | 10.6 | Schedule of Directors and Executive Officers with Indemnification Agreements, incorporated by reference to the corresponding exhibit filed with PolyOne’s Form 8-K on July 5, 2006 (SEC file No. 1-16091) |
| (10)+ | 10.7 | PolyOne Executive Severance Plan, effective May 25, 2006, filed herewith |
| (31) | 31.1 | Certification of Stephen D. Newlin, Chairman, President and Chief Executive Officer, pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| (31) | 31.2 | Certification of W. David Wilson, Senior Vice President and Chief Financial Officer, pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| (32) | 32.1 | Certification of Stephen D. Newlin, Chairman, President and Chief Executive Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| (32) | 32.2 | Certification of W. David Wilson, Senior Vice President and Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |

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

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SIGNATURES

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

| August 2, 2006 | POLYONE CORPORATION |
| --- | --- |
| | /s/ W. David Wilson<br>W. David Wilson<br>Senior Vice President and Chief Financial Officer<br>(Authorized Officer and Principal Financial Officer) |
| | /s/ Michael J. Meier<br>Michael J. Meier<br>Corporate Controller<br>(Authorized Officer and Principal Accounting Officer) |

**PolyOne Corporation**

Index to Exhibits

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

**Exhibit 10.7**

# POLYONE CORPORATION
# EXECUTIVE SEVERANCE PLAN
# (EFFECTIVE MAY 25, 2006)

## ARTICLE I — PURPOSE

The Board of Directors of PolyOne Corporation (the "Company") hereby adopts the PolyOne Corporation Executive Severance Plan (the "Plan"). The Plan is designed to provide severance protection to certain officers of the Company who are expected to make substantial contributions to the success of the Company and thereby provide for stability and continuity of operations.

## ARTICLE II — ESTABLISHMENT OF THE PLAN

**Section 2.1** The Plan is effective May 25, 2006 (the "Effective Date").

**Section 2.2** Applicability of Plan. The benefits provided by the Plan shall be available to Participants, as defined in Section 3.14.

**Section 2.3** Contractual Right to Benefits. Subject to the provisions of Article X hereof, the Plan establishes and vests in each Participant a contractual right to the benefits to which the Participant is entitled hereunder, enforceable by the Participant against the Company on the terms and subject to the conditions hereof.

## ARTICLE III — DEFINITIONS

**Section 3.1** "Affiliate" means, with respect to any person, any entity, directly or indirectly, controlled by, controlling or under common control with such person.

**Section 3.2** "Base Salary" of a Participant means the Participant's annual base salary as in effect on the Termination Date.

**Section 3.3** "Board" means the Board of Directors of the Company.

**Section 3.4** "Cause" means the Participant's commission of any of the following:

(a) Serious violation or deliberate disregard of the Company's policies;

(b) Gross dereliction in the performance of Participant's job duties and responsibilities;

(c) Violation of the Code of Business Conduct;

(d) Misappropriation of property of the Company or an Affiliate;

(e) Commission of an act of fraud upon, or bad faith, dishonesty or disloyalty toward the Company or any of its Affiliates;

(f) Breach of any of the covenants under Section 6.3 or Article VII;

(g) An event of egregious misconduct involving serious moral turpitude to the extent that, in the reasonable judgment of the Committee, the Participant's credibility and reputation no longer conforms to the standards applicable to Company executives; or

(h) An act or omission that the Company reasonably determines may prejudice significantly its best interests if the Participant's employment is not terminated.

**Section 3.5** "Code" means the Internal Revenue Code of 1986, as amended.

**Section 3.6** "Committee" means the Compensation and Governance Committee of the Board, or any successor committee of the Board that performs the executive compensation functions delegated to the Committee as of the Effective Date.

**Section 3.7** "Disability" means a Participant's incapacity due to physical or mental illness that results in a Participant being absent from the Participant's duties with an Employer on a full-time basis for a period of 180 consecutive days.

**Section 3.8** "Elected Officer" means an officer of the Company who is elected to office by the Board. An Elected Officer will not include an officer of the Company who is appointed by the Board.

**Section 3.9** "Employer" means the Company or any Affiliate that employs a Participant.

**Section 3.10** "ERISA" means the Employee Retirement Income Security Act of 1974, as amended.

**Section 3.11** "Executive Officer" means an Elected Officer who is elected to office by the Board in the category of "Executive Officer."

**Section 3.12** "Key Employee" means a key employee as defined in Section 416(i) of the Code (without regard to paragraph (5) thereof) of an Employer any stock of which is publicly traded on an established securities market or otherwise.

**Section 3.13** "Management Continuity Agreement" means an agreement entered into between the Company and a Participant that sets forth benefits that the Company agrees to provide the Participant under certain circumstances following a Change of Control (as defined in such agreement).

**Section 3.14** "Participant" means an Elected Officer and any other employee of an Employer who is expressly designated by the Committee as a Participant, who, after becoming a Participant, has not entered into an employment, severance or other similar agreement with the Company (other than a stock option, restricted stock, supplemental retirement, deferred compensation or similar plan or agreement or other form of participant document entered into pursuant to an Employer-sponsored plan that may contain provisions operative on a termination of the Participant's employment or may incidentally refer to accelerated vesting or accelerated

payment upon a Change of Control (as defined in such separate plan or document), such as a Management Continuity Agreement). Each individual who, as of the Effective Date, is an Elected Officer shall become a Participant as of the Effective Date. Each individual who, after the Effective Date, becomes an Elected Officer or is designed by the Committee as a Participant, shall become a Participant as of the date so elected or designated. A Participant shall cease to be a Participant hereunder when he or she is no longer an Elected Officer or, by action of the Committee, is no longer a Participant.

**Section 3.15** “Plan Administrator” means the Company.

**Section 3.16** “Separation from Service” has the meaning set forth in Section 409A of the Code.

**Section 3.17** “Severance Payment” or “Severance Payments” means the amount or amounts to be paid to a Participant under Article IV hereof.

**Section 3.18** “Severance Period” means (a) for all Executive Officers other than the Chief Executive Officer of the Company, the period of time commencing on the Termination Date and continuing until the second anniversary of the Termination Date, and (b) for all other Participants, the period of time commencing on the Termination Date and continuing until the first anniversary of the Termination Date.

**Section 3.19** “Termination Date” means the date on which the Participant’s employment with an Employer terminates.

**Section 3.20** “409A Guidance” means Section 409A of the Code, including proposed, temporary or final regulations or any other guidance issued by the Secretary of the Treasury and the Internal Revenue Service with respect thereto.

## ARTICLE IV — SEVERANCE PAYMENTS

**Section 4.1** Right to Severance Payment.

(a) Subject to Section 5.1, a Participant shall be entitled to receive from the Company Severance Payments in the amount provided in Section 4.1(b), payable as described in Section 4.1(d), upon the termination by the Employers of the Participant’s employment without Cause and for reasons other than death or Disability.

(b) The amount of Severance Payments under this Section 4.1(b) shall equal the sum of:

(i) the Participant’s Base Salary multiplied by (i) two in the case of Executive Officers or (ii) one in the case of all other Participants; and

(ii) the Participant’s annual bonus under the Company’s annual incentive program in which the Participant participates as earned for the year in which the Termination Date occurs;

minus the sum of:

(iii) the amount equal to the aggregate amount of any other cash payments in the nature of severance payments, if any, paid or payable to the Participant by an Employer pursuant to any agreement, plan, program, arrangement or requirement of statutory or common law (other than this Plan or cash payments received in lieu of stock incentives); and

(iv) the amount, if any, the Participant may be required to repay to the Company under the Company's relocation program.

(c) Except as provided in the following paragraph, in the event a Participant is entitled to severance payments under this Article IV, the Company shall provide the Participant continued participation in the Company's medical, dental and vision plans (the "Health Plans") for the Severance Period, subject to the terms and conditions of the Health Plans, including, but not limited to, timely payment of any employee contributions necessary to maintain participation; provided, however, that such coverage shall be provided only to the extent that such coverage would not be considered "deferred compensation" subject to the requirements of Section 409A of the Code.

The Participant's continued participation in the Health Plans for the Severance Period shall satisfy the Health Plans' obligation to provide the Participant the right to continuation coverage under the Health Plans pursuant to the Consolidated Omnibus Budget Reconciliation Act of 1986, as amended; provided, however, that for any Participant with a two-year Severance Period, continued participation in the Health Plans shall be limited to the period beginning on the Termination Date and ending on the eighteen-month anniversary of the Termination Date, and the Company shall pay such Participant in a lump sum on the Initial Payment Date, as defined below, the present value of continued participation in the Health Plans for the last six months of the Severance Period.

(d) (i) The Severance Payment paid pursuant to Section 4.1(b)(i) shall be paid in equal installments during the period beginning on the date 60 calendar days after the Participant's Separation from Service and ending at the end of the Severance Period according to the Company's then current payroll policies. The first installment to which a Participant is entitled under this Section 4.1(d)(i) shall be paid with the first normal pay period that occurs on or after 60 calendar days after the Participant's Separation from Service and shall include any installments that would have been paid during the Severance Period but for the 60-day delay in commencement of payment. The amount of each installment shall be equal to the total amount of the Severance Payment paid pursuant to Section 4.1(b)(i) divided by the number of payroll dates in the Severance Period.

(ii) Except to the extent subject to a valid deferral election executed by the Participant that would require payment at a different time, the Severance Payment paid pursuant to Section 4.1(b)(ii) shall be paid during the calendar year immediately following the calendar year in which the performance objectives giving rise to such annual bonus payment are satisfied.

(iii) Notwithstanding the foregoing, if any of the Severance Payments described in Section 4.1(d)(i) or Section 4.1(d)(ii) would be considered "nonqualified deferred compensation," within the meaning of Section 409A of the Code, then to the extent necessary to comply with Section 409A of the Code and to the extent payable to a Participant who is a Key Employee, such payment shall not be made during the six-month period following the Participant's Separation from Service. Any Severance Payments that would, but for the foregoing sentence, be paid during such six-month period, shall be paid to the Participant by the Company in cash and in full, as soon as practicable following six months after the Participant's Separation from Service (the "Initial Payment Date").

(iv) If a Participant entitled to Severance Payments under this Section 4.1 should die before all amounts payable to him or her have been paid, such unpaid amounts shall be paid as soon as practicable following the Participant's death to the Participant's legal representative, if there be one, and, if not, to the Participant's spouse, parents, children or other relatives or dependents of such Participant as the Company, in its discretion, may determine. Any payment so made shall be a complete discharge of any liability with respect to such benefit.

**Section 4.2** Business Expenses. Each Participant shall be responsible for any personal charges incurred on any Company credit card or other account used by the Participant prior to the Participant's Termination Date and the Participant shall pay all such charges when due. The Company shall reimburse the Participant for any pending, reasonable business-related credit card charges for which the Participant has not already been reimbursed as of the Participant's Termination Date provided the Participant files a proper travel and expense report.

**Section 4.3** Outplacement. Each Participant shall be eligible to initiate outplacement services with the Company's designated service provider within 90 days of the Termination Date. Any fees for such outplacement benefits shall be paid by the Company directly to the outplacement service provider and such services shall be completed within 12 months after the date the Participant so initiates outplacement services.

**Section 4.4** Withholding. The Company shall withhold such amounts from the payments described in this Article IV as are required by applicable tax or other law.

**Section 4.5** Other Rights and Obligations.

(a) Nothing in this Plan will affect the rights that a Participant may have, based on termination of the Participant's employment as of the Termination Date, pursuant to any agreement, policy, plan, program or arrangement of the Company providing for payment of accrued vacation pay, long-term incentive compensation or retirement benefits under the PolyOne Corporation Retirement Savings Plan or any other qualified or non-qualified retirement plan of the Company or any Affiliate, which rights will be governed by the terms thereof, as such agreements, policies, plans, programs or arrangements may be modified from time to time consistent with the terms of such agreements, policies, plans, programs or arrangements.

(b) Except as specifically set forth in this Plan, no other compensation or benefits are due to a Participant under this Plan, the PolyOne Employee Transition Plan, the Management Continuity Agreement, or any other agreement, policy or program of the Company. If the Participant has entered into a Management Continuity Agreement with the Company and is entitled to payment under such Management Continuity Agreement, then the Participant is not eligible to receive benefits under this Plan.

(c) In connection with the termination of the Participant's employment, such Participant shall follow the Company's standard procedures relating to departing employees, including, without limitation, returning (and providing confirmation that the Participant has so returned) all Company owned property, documents and materials (including copies, reproductions, summaries and/or analyses), and all other materials that contain, reflect, summarize, describe, analyze or refer or relate to any items of Information (as defined in Article VII below).

(d) The Participant shall not be required to mitigate damages or the amount of the Participant's Severance Payment by seeking other employment or otherwise, nor, except as provided in the following sentence, shall the amount of such payment be reduced by any compensation earned by the Participant as a result of employment after the termination of the Participant's employment by the Employers. In the event a person receiving benefits under the Plan is reemployed by an Employer, all payments then payable will cease.

## ARTICLE V — RELEASE

**Section 5.1** Release. Notwithstanding anything to the contrary contained in this Plan, a Participant shall not be entitled to receive any Severance Payment hereunder unless and until the Participant has signed and returned to the Company a release (the "Release") by the deadline established by the Plan Administrator (which shall be no later than 50 calendar days after the Participant's Termination Date) and the period during which the Participant may revoke the Release, if any, has elapsed. The Release, which shall be signed by the Participant no earlier than the Participant's Termination Date, shall be a written document, in a form prescribed by the Company, intended to create a binding agreement by a Participant to release any claim that the Participant has or may have against the Company and certain related entities and individuals, that arise on or before the date on which Participant signs the Release, including, without limitation, any claims under the federal Age Discrimination in Employment Act.

**Section 5.2** Breach. The Company's payment obligations and the Participant's participation rights under Article IV shall cease in the event the Participant breaches any of the covenants contained in the Release or in Articles VI or VII.

## ARTICLE VI — NON-COMPETITION, NON- SOLICITATION, AND NON-DISPARAGEMENT

**Section 6.1** Non-Competition. From the Termination Date until the conclusion of the Severance Period, a Participant shall not, without prior written consent of the Company (to be decided by the Plan Administrator upon submission of a written request by the Participant

describing the specific opportunity for which consent is sought), engage, directly or indirectly, either personally or as an employee, director, partner, agent, representative, or consultant for another, in any activity that competes directly or indirectly with the Company or any of its Affiliates in any products, services, systems, or other business activities (or in any product, service, system, or business activity that was under either active development or consideration while the Participant was employed by the Company). The foregoing sentence of this Section 6.1 is intended to cover and encompass activity by a Participant that poses a competitive threat to the Company or any of its Affiliates. The Company competes worldwide in the sale of products, services, systems, and business activities and the market for technology related to its products, services, systems, and business activities is worldwide. For purposes of this Section 6.1, indirect competition shall include engaging in any of the prohibited activities through an intermediary or third-party or as a shareholder of any corporation in which a Participant or Participant's immediate family member owns, directly or indirectly, individually or in the aggregate, more than five percent (5%) of the outstanding stock.

**Section 6.2** Non-Solicitation. From the Termination Date until the conclusion of the Severance Period, a Participant shall not directly or indirectly (a) induce or assist others in inducing any person who is an employee, officer, consultant, or agent of the Company or its Affiliates to give up employment or business affiliation with the Company or its Affiliates; or (b) employ or associate in business with any person who is employed by or associated in business with the Company or its Affiliates at any time during the Severance Period or in the one-year period prior to the Termination Date; provided, however, that the foregoing shall not prohibit the Participant, or any business with whom Participant becomes associated, from engaging in general solicitations of employment or hiring persons that respond to such solicitations. In the event that the scope of the restrictions in Sections 6.1 or 6.2 are found overly broad, a court should reform the restrictions by limiting them to the maximum reasonable scope.

**Section 6.3** Statements to Third Parties. A Participant shall not, directly or indirectly, make or cause to be made any statements to any third parties criticizing or disparaging the Company or comment on its character or business reputation. A Participant further shall not: (a) comment to others concerning the status, plans or prospects of the business of the Company, or (b) engage in any act or omission that would be detrimental, financially or otherwise, to the Company, or that would subject the Company to public disrespect, scandal, or ridicule. For purposes of this Section 6.3, the "Company" shall mean PolyOne Corporation and its directors, officers, predecessors, and Affiliates. The foregoing undertakings shall not apply to any statements or opinions that are made under oath in any investigation, civil or administrative proceeding or arbitration in which the individual has been compelled to testify by subpoena or other judicial process or which are privileged communications.

## ARTICLE VII — CONFIDENTIAL INFORMATION

As an employee of the Company or an Affiliate, a Participant may have created or had access to information, trade secrets, substances and inventions including confidential information relating to the business or interests of persons with whom the Company or any of its Affiliates may have commercial, technical, or scientific relations ("Information") that is valuable to the Company or any of its Affiliates and may lose its value if disclosed to third parties. Participants shall treat all such Information as confidential and belonging to the Company and take all actions

reasonably requested to confirm such ownership. A Participant shall not, without the prior written consent of the Company, disclose or use the Information. This non-disclosure obligation shall continue until such Information becomes public knowledge through no fault of the Participant. A Participant shall promptly inform the Company of any request, order, or legal process requesting or requiring the Participant to disclose Information. A Participant shall cooperate with legal efforts by the Company to prevent or limit disclosure of Information.

## ARTICLE VIII — SUCCESSORS; THIRD PARTY BENEFICIARIES

**Section 8.1** Participant's Successors. This Plan shall inure to the benefit of and be enforceable by the Participant's personal or legal representatives, executors, administrators, successors, heirs, distributees and/or legatees.

**Section 8.2** Exclusive Benefit. This Plan is intended to be for the exclusive benefit of the Company and the Participants, and except as provided in Section 8.1, no third party shall have any rights hereunder.

## ARTICLE IX — AMENDMENT AND TERMINATION

The Company, through the Committee, reserves the right to amend or terminate the Plan at any time without any prior notice to or approval of any Participant without any notice to or approval of any other Employer. Any such amendment or termination may be retroactive to any date up to and including the effective date of the Plan; provided, however, that no such amendment, modification or change shall adversely affect any benefit under the Plan previously paid or provided to a Participant (or a Participant's successor in interest).

## ARTICLE X — ADMINISTRATION OF PLAN

**Section 10.1** Administration.

(a) The Plan shall be administered by the Plan Administrator. The Plan Administrator shall have the sole and absolute discretion to interpret where necessary all provisions of the Plan (including, without limitation, by supplying omissions from, correcting deficiencies in, or resolving inconsistencies or ambiguities in, the language of the Plan), to make factual findings with respect to any issue arising under the Plan, to determine the rights and status under the Plan of Participants or other persons, to resolve questions (including factual questions) or disputes arising under the Plan and to make any determinations with respect to the benefits payable under the Plan and the persons entitled thereto as may be necessary for the purposes of the Plan. Without limiting the generality of the foregoing, the Plan Administrator is hereby granted the authority (i) to determine whether a particular employee is a Participant, and (ii) to determine if a person is entitled to benefits hereunder and, if so, the amount and duration of such benefits. The Plan Administrator's determination of the rights of any person hereunder shall be final and binding on all persons, subject only to the provisions of Section 10.3 hereof.

(b) The Plan Administrator may delegate any of its administrative duties, including, without limitation, duties with respect to the processing, review, investigation, approval and payment of benefits, to a named administrator or administrators.

(c) The Plan Administrator shall not take any action that would violate any provisions of Section 409A of the Code. The Plan Administrator is authorized to adopt rules or regulations deemed necessary or appropriate in connection therewith to anticipate and/or comply with the requirements thereof (including any transition rules thereunder).

**Section 10.2** Regulations. The Plan Administrator shall promulgate any rules and regulations it deems necessary in order to carry out the purposes of the Plan or to interpret the provisions of the Plan; provided, however, that no rule, regulation or interpretation shall be contrary to the provisions of the Plan or the 409A Guidance. The rules, regulations and interpretations made by the Plan Administrator shall, subject only to the provisions of Section 10.3 hereof, be final and binding on all persons.

**Section 10.3** Claims Procedures.

(a) The Plan Administrator shall determine the rights of any person to any benefit hereunder. Any person who believes that he or she has not received the benefit to which he or she is entitled under the Plan must file a claim in writing with the Plan Administrator specifying the basis for his or her claim and the facts upon which he or she relies in making such a claim.

(b) The Plan Administrator will notify the claimant of its decision regarding his or her claim within a reasonable period of time, but not later than 90 days following the date on which the claim is filed, unless special circumstances require a longer period for adjudication and the claimant is notified in writing of the reasons for an extension of time prior to the end of the initial 90-day period and the date by which the Plan Administrator expects to make the final decision. In no event will the Plan Administrator be given an extension for processing the claim beyond 180 days after the date on which the claim is first filed with the Plan Administrator.

If such a claim is denied, the Plan Administrator’s notice will be in writing, will be written in a manner calculated to be understood by the claimant and will contain the following information:

(i) The specific reason(s) for the denial;

(ii) A specific reference to the pertinent Plan provision(s) on which the denial is based;

(iii) A description of additional information or material necessary for the claimant to perfect his or her claim, if any, and an explanation of why such information or material is necessary; and

(iv) An explanation of the Plan’s claim review procedure and the applicable time limits under such procedure and a statement as to the claimant’s right to bring a civil action under ERISA after all of the Plan’s review procedures have been satisfied.

If additional information is needed, the claimant shall be provided at least 45 days within which to provide the information and any otherwise applicable time period for making a determination shall be suspended during the period the information is being obtained.

Within 60 days after receipt of a denial of a claim, the claimant must file with the Plan Administrator, a written request for review of such claim. If a request for review is not filed within such 60-day period, the claimant shall be deemed to have acquiesced in the original decision of the Plan Administrator on his or her claim. If a request for review is filed, the Plan Administrator shall conduct a full and fair review of the claim. The claimant will be provided, upon request and free of charge, reasonable access to and copies of all documents and information relevant to the claim for benefits. The claimant may submit issues and comments in writing, and the review must take into account all information submitted by the claimant regardless of whether it was reviewed as part of the initial determination. The decision by the Plan Administrator with respect to the review must be given within 60 days after receipt of the request for review, unless circumstances warrant an extension of time not to exceed an additional 60 days. If this occurs, written notice of the extension will be furnished to the claimant before the end of the initial 60-day period, indicating the special circumstances requiring the extension and the date by which the Plan Administrator expects to make the final decision. The decision shall be written in a manner calculated to be understood by the claimant, and it shall include

(A) The specific reason(s) for the denial;

(B) A reference to the specific Plan provision(s) on which the denial is based;

(C) A statement that the claimant is entitled to receive, upon request and free of charge, reasonable access to and copies of all information relevant to the claimant's claim for benefits; and

(D) A statement describing any voluntary appeal procedures offered by the Plan and a statement of the claimant's right to bring a civil action under ERISA.

The Plan Administrator's decision on review shall be, to the extent permitted by applicable law, final and binding on all interested persons.

**Section 10.4** Mediation. After a Participant has exhausted all administrative remedies as provided in Section 10.3, the Participant may submit any dispute to mediation by written notice to the other party or parties. The mediator shall be selected by agreement of the parties. If the parties cannot agree on a mediator, a mediator shall be designated by the American Arbitration Association at the request of a party. Any mediator so designated must be acceptable to all parties. The mediation shall be conducted as specified by the mediator and agreed upon by the parties. The parties agree to discuss their differences in good faith and to attempt, with facilitation by the mediator, to reach an amicable resolution of the dispute. The mediation shall be treated as a settlement discussion and therefore shall be confidential. The mediator may not testify for either party in any later proceeding relating to the dispute. No recording or transcript shall be made of the mediation proceedings. Each party shall bear its own costs in the mediation. The fees and expenses of the mediator shall be shared equally by the parties.

## ARTICLE XI — MISCELLANEOUS

**Section 11.1** Alienation. Except as otherwise required by law, no benefit shall be subject in any way to alienation, sale, transfer, assignment, pledge, attachment, garnishment, execution or encumbrance of any kind, and any attempt to accomplish the same shall be void.

**Section 11.2** Incapacity. Benefits shall be payable hereunder only to a Participant who is eligible therefore, except that if the Company shall find that such Participant is unable to manage his or her affairs for any reason, any benefit payable to him or her shall be paid to his or her duly appointed legal representative, if there be one, and, if not, to the spouse, parents, children or other relatives or dependents of such Participant as the Company, in its discretion, may determine. Any payment so made shall be a complete discharge of any liability with respect to such benefit.

**Section 11.3** Employment Rights. The Participant's rights, and the Company's rights to discharge a Participant shall not be enlarged or affected by reason of the Plan. Nothing contained in the Plan shall be deemed to alter in any manner the management rights of the Company or any of its Affiliates.

**Section 11.4** Notices. For all purposes of this Plan, all communications, including, without limitation, notices, consents, requests or approvals provided for herein, shall be in writing and shall be deemed to have been duly given when delivered, addressed to the Company (to the attention of the Chief Legal Officer) at its principal executive offices and to any Participant at his principal residential address on file with the Company, or to such other address as any party may have furnished to the other in writing and in accordance herewith. Notices of change of address shall be effective only upon receipt.

**Section 11.5** Governing Law. Any dispute, controversy, or claim of whatever nature arising out of or relating to this Plan or breach thereof shall be governed by and under the laws of the State of Ohio without regard to conflict of law principles.

**Section 11.6** Validity. The invalidity or unenforceability of any provision of this Plan shall not affect the validity or enforceability of any other provision of this Plan, which shall nevertheless remain in full force and effect.

**Section 11.7** Captions and Paragraph Headings. Captions and paragraph headings used herein are for convenience and are not part of this Plan and shall not be used in construing it.

**Exhibit 31.1**

**CERTIFICATION**

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

1. I have reviewed this quarterly report on Form 10-Q 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 in this report our conclusions 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.

August 2, 2006

/s/ Stephen D. Newlin

Stephen D. Newlin
Chairman, President and Chief Executive Officer

**Exhibit 31.2**

**CERTIFICATION**

I, W. David Wilson, Senior Vice President and Chief Financial Officer of PolyOne Corporation ("registrant"), certify that:

1. I have reviewed this quarterly report on Form 10-Q 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 in this report our conclusions 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.

August 2, 2006

/s/ W. David Wilson

W. David Wilson
Senior Vice President and
Chief Financial Officer

**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 Quarterly Report on Form 10-Q of PolyOne Corporation (the “Company”) for the period ended June 30, 2006, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, Stephen D. Newlin, Chairman, President and Chief Executive Officer of the Company, do hereby certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that, to 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
Chairman, President and Chief Executive Officer
August 2, 2006

The foregoing certification is being furnished solely pursuant to 18 U.S.C. § 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 Quarterly Report on Form 10-Q of PolyOne Corporation (the “Company”) for the period ended June 30, 2006, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), I, W. David Wilson, Senior Vice President and Chief Financial Officer of the Company, do hereby certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that, to 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
Senior Vice President and Chief Financial Officer
August 2, 2006

The foregoing certification is being furnished solely pursuant to 18 U.S.C. § 1350 and is not being filed as part of the Report or as a separate disclosure document.