

STEPAN CO  
Form 10-Q  
October 30, 2013

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

**FORM 10-Q**

(MARK ONE)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2013**

**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 1-4462**

**STEPAN COMPANY**  
**(Exact name of registrant as specified in its charter)**

**Delaware** **36-1823834**  
**(State or other jurisdiction of** **(I.R.S. Employer**  
**incorporation or organization)** **Identification Number)**  
**Edens and Winnetka Road, Northfield, Illinois 60093**  
**(Address of principal executive offices)**  
**Registrant's telephone number (847) 446-7500**

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

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

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

Large accelerated filer  Accelerated filer   
Non-accelerated filer  Smaller reporting company

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

| Class                       | Outstanding at October 24, 2013 |
|-----------------------------|---------------------------------|
| Common Stock, \$1 par value | 22,318,652 Shares               |

**Part I FINANCIAL INFORMATION****Item 1 Financial Statements**

## STEPAN COMPANY

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME

Unaudited

| <i>(In thousands, except per share amounts)</i>  | Three Months Ended |            | Nine Months Ended |              |
|--|--------------------|------------|-------------------|--------------|
|  | September 30       |            | September 30      |              |
|  | 2013               | 2012       | 2013              | 2012         |
| <b>Net Sales</b>                                 | \$ 475,466         | \$ 440,978 | \$ 1,406,457      | \$ 1,376,478 |
| Cost of Sales                                    | 401,125            | 369,725    | 1,185,709         | 1,155,045    |
| Gross Profit                                     | 74,341             | 71,253     | 220,748           | 221,433      |
| Operating Expenses:                              |                    |            |                   |              |
| Selling  | 12,895             | 12,128     | 41,063            | 38,764       |
| Administrative                                   | 18,127             | 14,389     | 49,008            | 45,427       |
| Research, development and technical services     | 12,234             | 10,845     | 35,429            | 33,130       |
|  | 43,256             | 37,362     | 125,500           | 117,321      |
| Operating Income                                 | 31,085             | 33,891     | 95,248            | 104,112      |
| Other Income (Expense):                          |                    |            |                   |              |
| Interest, net                                    | (2,987)            | (2,684)    | (7,495)           | (7,374)      |
| Loss from equity in joint ventures               | (1,325)            | (1,376)    | (4,061)           | (3,817)      |
| Other, net (Note 14)                             | 1,074              | 404        | 1,628             | 1,552        |
|  | (3,238)            | (3,656)    | (9,928)           | (9,639)      |
| Income Before Provision for Income Taxes         | 27,847             | 30,235     | 85,320            | 94,473       |
| Provision for Income Taxes                       | 7,698              | 9,916      | 23,520            | 30,279       |
| Net Income                                       | 20,149             | 20,319     | \$ 61,800         | \$ 64,194    |
| Net (Income) Loss Attributable to                |                    |            |                   |              |
| Noncontrolling Interests (Note 3)                | 253                | (89)       | 378               | (237)        |
| <b>Net Income Attributable to Stepan Company</b> | \$ 20,402          | \$ 20,230  | \$ 62,178         | \$ 63,957    |
| Net Income Per Common Share Attributable to      |                    |            |                   |              |
| Stepan Company (Note 10):                        |                    |            |                   |              |
| Basic  | \$ 0.90            | \$ 0.95    | \$ 2.75           | \$ 3.01      |

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|   |         |         |         |         |
|---|---------|---------|---------|---------|
| Diluted   | \$ 0.89 | \$ 0.89 | \$ 2.71 | \$ 2.82 |
| Shares Used to Compute Net Income Per Common Share<br>Attributable to Stepan Company (Note 10): |         |         |         |         |
| Basic   | 22,700  | 21,162  | 22,576  | 21,106  |
| Diluted   | 22,936  | 22,736  | 22,914  | 22,708  |
| Dividends Declared Per Common Share   | \$ 0.16 | \$ 0.14 | \$ 0.48 | \$ 0.42 |

All share and per share data reflect the effects of the two-for-one common stock split that was effective December 14, 2012.

The accompanying Notes to Condensed Consolidated Financial Statements are an integral part of these financial statements.

## STEPAN COMPANY

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Unaudited

| <i>(In thousands)</i>  | Three Months<br>Ended<br>September 30 |           | Nine Months Ended<br>September 30 |           |
|--|---------------------------------------|-----------|-----------------------------------|-----------|
|  | 2013                                  | 2012      | 2013                              | 2012      |
| Net income   | \$ 20,149                             | \$ 20,319 | \$ 61,800                         | \$ 64,194 |
| Other comprehensive income (loss):   |                                       |           |                                   |           |
| Foreign currency translation adjustments (Note 11)                               | 5,752                                 | 5,513     | (6,806)                           | 3,493     |
| Pension liability adjustment, net of tax (Note 11)                               | 810                                   | 512       | 2,538                             | 1,676     |
| Derivative instrument activity, net of tax (Note 11)                             | 3                                     | 34        | (18)                              | 98        |
| Other comprehensive income (loss)  | 6,565                                 | 6,059     | (4,286)                           | 5,267     |
| Comprehensive income   | 26,714                                | 26,378    | 57,514                            | 69,461    |
| Comprehensive (income) loss attributable to noncontrolling interests<br>(Note 3) | 248                                   | (97)      | 344                               | (299)     |
| Comprehensive income attributable to Stepan Company                              | \$ 26,962                             | \$ 26,281 | \$ 57,858                         | \$ 69,162 |

The accompanying Notes to Condensed Consolidated Financial Statements are an integral part of these financial statements.

STEPAN COMPANY  
CONDENSED CONSOLIDATED BALANCE SHEETS

Unaudited

| <i>(In thousands)</i>                                    | September 30,<br>2013 | December 31,<br>2012 |
|--|-----------------------|----------------------|
| <b>Assets</b>  |                       |                      |
| <b>Current Assets:</b>                                   |                       |                      |
| Cash and cash equivalents                                | \$ 103,088            | \$ 76,875            |
| Receivables, net   | 293,142               | 255,858              |
| Inventories (Note 7)                                     | 178,402               | 162,013              |
| Deferred income taxes                                    | 9,797                 | 9,876                |
| Other current assets                                     | 24,471                | 18,456               |
| <b>Total current assets</b>                              | <b>608,900</b>        | <b>523,078</b>       |
| <b>Property, Plant and Equipment:</b>                    |                       |                      |
| Cost (Note 2)  | 1,293,619             | 1,200,355            |
| Less: accumulated depreciation                           | 812,695               | 778,333              |
| <b>Property, plant and equipment, net</b>                | <b>480,924</b>        | <b>422,022</b>       |
| Goodwill, net (Note 2)                                   | 11,737                | 7,199                |
| Other intangible assets, net (Note 2)                    | 24,433                | 8,778                |
| Long-term investments (Note 4)                           | 16,917                | 14,093               |
| Other non-current assets                                 | 10,493                | 10,308               |
| <b>Total assets</b>                                      | <b>\$ 1,153,404</b>   | <b>\$ 985,478</b>    |
| <b>Liabilities and Equity</b>                            |                       |                      |
| <b>Current Liabilities:</b>                              |                       |                      |
| Current maturities of long-term debt (Note 13)           | \$ 35,230             | \$ 32,838            |
| Accounts payable   | 156,126               | 141,668              |
| Accrued liabilities                                      | 74,542                | 72,661               |
| <b>Total current liabilities</b>                         | <b>265,898</b>        | <b>247,167</b>       |
| Deferred income taxes                                    | 13,364                | 9,200                |
| <b>Long-term debt, less current maturities (Note 13)</b> | <b>241,575</b>        | <b>149,564</b>       |
| Other non-current liabilities                            | 99,741                | 98,667               |
| <b>Commitments and Contingencies (Note 8)</b>            |                       |                      |
| <b>Equity:</b>   |                       | <b>1,548</b>         |

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5-1/2% convertible preferred stock, cumulative, voting, without par value; authorized 2,000,000 shares; issued and outstanding 0 shares in 2013 and 61,935 shares in 2012

(Note 15)

Common stock, \$1 par value; authorized 60,000,000 shares; Issued 25,544,579 shares in 2013 and 25,141,610 shares in 2012

|   |                     |                   |
|---|---------------------|-------------------|
|   | 25,545              | 25,142            |
| Additional paid-in capital  | 134,506             | 125,003           |
| Accumulated other comprehensive loss (Note 11)  | (42,570)            | (38,250)          |
| Retained earnings   | 471,972             | 420,472           |
| Less: Common treasury stock, at cost, 3,229,727 shares in 2013 and 3,175,638 shares in 2012 | (58,178)            | (54,930)          |
| <b>Total Stepan Company stockholders equity</b>   | <b>531,275</b>      | <b>478,985</b>    |
| Noncontrolling interests (Note 3)   | 1,551               | 1,895             |
| <b>Total equity</b>   | <b>532,826</b>      | <b>480,880</b>    |
| <b>Total liabilities and equity</b>   | <b>\$ 1,153,404</b> | <b>\$ 985,478</b> |

The accompanying Notes to Condensed Consolidated Financial Statements are an integral part of these financial statements.

## STEPAN COMPANY

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

Unaudited

| <i>(In thousands)</i>   | Nine Months Ended<br>September 30 |                 |
|---|-----------------------------------|-----------------|
|   | 2013                              | 2012            |
| <b>Cash Flows From Operating Activities</b>                                       |                                   |                 |
| Net income  | \$ 61,800                         | \$ 64,194       |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                   |                 |
| Depreciation and amortization   | 41,450                            | 37,942          |
| Deferred compensation   | 3,492                             | 6,262           |
| Realized and unrealized gain on long-term investments                             | (2,186)                           | (1,717)         |
| Stock-based compensation  | 1,420                             | 749             |
| Deferred income taxes   | 2,793                             | 3,389           |
| Other non-cash items  | 5,871                             | 4,037           |
| Changes in assets and liabilities:  |                                   |                 |
| Receivables, net  | (41,145)                          | (5,531)         |
| Inventories   | (9,631)                           | (44,142)        |
| Other current assets  | (5,867)                           | (2,186)         |
| Accounts payable and accrued liabilities  | 26,585                            | 24,708          |
| Pension liabilities   | 1,358                             | (4,798)         |
| Environmental and legal liabilities   | (651)                             | (285)           |
| Deferred revenues   | (305)                             | (662)           |
| Excess tax benefit from stock options and awards                                  | (3,278)                           | (3,925)         |
| <b>Net Cash Provided By Operating Activities</b>                                  | <b>81,706</b>                     | <b>78,035</b>   |
| <b>Cash Flows From Investing Activities</b>                                       |                                   |                 |
| Expenditures for property, plant and equipment                                    | (67,077)                          | (60,855)        |
| Business acquisition (Note 2)   | (68,212)                          |                 |
| Sale of mutual funds  | 571                               | 537             |
| Other, net  | (5,142)                           | (2,875)         |
| <b>Net Cash Used In Investing Activities</b>                                      | <b>(139,860)</b>                  | <b>(63,193)</b> |
| <b>Cash Flows From Financing Activities</b>                                       |                                   |                 |
| Revolving debt and bank overdrafts, net   | 6,412                             | (2,693)         |
| Other debt borrowings   | 100,000                           |                 |
| Other debt repayments   | (12,567)                          | (8,581)         |
| Dividends paid  | (10,678)                          | (9,234)         |
| Company stock repurchased   | (2,275)                           | (1,000)         |
| Stock option exercises  | 3,715                             | 3,430           |
| Payment to noncontrolling interest (Note 17)                                      |                                   | (2,000)         |
| Excess tax benefit from stock options and awards                                  | 3,278                             | 3,925           |
| Other, net  | (1,606)                           | (3,708)         |



|  |            |           |
|--|------------|-----------|
| Net Cash Provided By (Used In) Financing Activities  | 86,279     | (19,861)  |
| Effect of Exchange Rate Changes on Cash              | (1,912)    | 575       |
| Net Increase (Decrease) in Cash and Cash Equivalents | 26,213     | (4,444)   |
| Cash and Cash Equivalents at Beginning of Period     | 76,875     | 84,099    |
| Cash and Cash Equivalents at End of Period           | \$ 103,088 | \$ 79,655 |
| <b>Supplemental Cash Flow Information</b>            |            |           |
| Cash payments of income taxes, net of refunds        | \$ 18,151  | \$ 20,638 |
| Cash payments of interest                            | \$ 5,482   | \$ 6,224  |

The accompanying Notes to Condensed Consolidated Financial Statements are an integral part of these financial statements.

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STEPAN COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2013

Unaudited

1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The condensed consolidated financial statements included herein have been prepared by Stepan Company (Company), without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations, although management believes that the disclosures are adequate and make the information presented not misleading. In the opinion of management, all adjustments, consisting only of normal recurring accruals, necessary to present fairly the Company's financial position as of September 30, 2013, and its results of operations for the three and nine months ended September 30, 2013 and 2012, and cash flows for the nine months ended September 30, 2013 and 2012, have been included. These financial statements and related footnotes should be read in conjunction with the financial statements and related footnotes included in the Company's 2012 Form 10-K.

2. ACQUISITION

On June 1, 2013, the Company acquired the North American polyester resins business of Bayer MaterialScience LLC (BMS). Prior to the acquisition, BMS was a North American producer of powder polyester resins for metal coating applications and liquid polyester resins for coatings, adhesives, sealants and elastomers (CASE) applications. The purchase included a 21,000-ton production facility in Columbus, Georgia, and a modern research and development laboratory for customer technical support and new product development. Infrastructure is in place to allow for future expansion. The acquisition has diversified the Company's polyol product offering and is expected to accelerate the Company's growth in CASE and PUSH (polyurethane systems house) applications. As of the acquisition date, the new business and acquired net assets became a part of the North American operations reporting unit included in the Company's polymers reportable segment. The new business's post-acquisition net sales included in consolidated net sales for the three and nine months ended September 30, 2013, were \$13,734,000 and \$18,175,000, respectively. The acquisition's effect on earnings was immaterial for the three and nine months ended September 30, 2013.

The total acquisition purchase price was \$68,212,000 cash, of which \$61,067,000 was paid at closing and \$7,145,000 primarily for inventory was paid over a three-month period (June 2013 through August 2013) pursuant to a transition services agreement with BMS. The acquisition was originally funded through the Company's committed revolving credit agreement. Subsequent to closing on the acquisition, the Company completed a \$100,000,000 private placement loan, which was used in part to finance the acquisition (see Note 13 for additional information regarding the private placement loan).

In addition to the purchase price paid, the Company incurred \$270,000 of acquisition-related expenses relating to legal, consulting, valuation and accounting services. These costs were reflected in administrative expenses on the Company's consolidated statement of income in the second quarter ended June 30, 2013.

The acquisition was accounted for as a business combination and, accordingly, the assets acquired and liabilities assumed as part of the acquisition were measured and recorded at their estimated fair values. The following table summarizes the assets acquired and liabilities assumed:

| <i>(Dollars in thousands)</i>  | June 1, 2013 |
|--------------------------------|--------------|
| <b>Assets:</b>                 |              |
| Inventory                      | \$ 9,002     |
| Property, plant and equipment  | 37,000       |
| Identifiable intangible assets | 17,800       |
| Goodwill                       | 4,642        |
| <br>                           |              |
| Total assets acquired          | \$ 68,444    |
| <br>                           |              |
| <b>Liabilities:</b>            |              |
| Accrued expenses               | 232          |
| <br>                           |              |
| Net assets acquired            | \$ 68,212    |

The acquired goodwill, which was assigned entirely to the Company's North American operations reporting unit included in the Company's polymers reportable segment, is deductible for tax purposes. The goodwill reflects the potential marketing, manufacturing and raw material sourcing synergies of the new business with the Company's existing polymer business. Identifiable intangible assets included a technology and manufacturing know-how license agreement (\$7,900,000), a trademark/trade name (\$3,800,000) and customer relationships (\$6,100,000). The amortization periods for these intangibles at the time of acquisition were 8, 11 and 12 years, respectively. The purchase price allocation is final. There were no changes to the amounts reported for the three and six months ended June 30, 2013.

The following is pro forma financial information prepared under the assumption that the acquisition of the BMS North American polyester resins business occurred on January 1, 2012.

*Pro Forma Financial Information*

*Unaudited*

| <i>(In thousands, except per share amounts)</i>             | Three Months Ended<br>September 30 |            | Nine Months Ended<br>September 30 |              |
|---|------------------------------------|------------|-----------------------------------|--------------|
|   | 2013                               | 2012       | 2013                              | 2012         |
| Net Sales   | \$ 475,466                         | \$ 457,263 | \$ 1,433,278                      | \$ 1,425,243 |
| Net Income Attributable to Stepan Company                   | \$ 20,603                          | \$ 20,988  | \$ 63,064                         | \$ 64,708    |
| Net Income Per Common Share Attributable to Stepan Company: |                                    |            |                                   |              |
| Basic   | \$ 0.91                            | \$ 0.98    | \$ 2.79                           | \$ 3.04      |
| Diluted   | \$ 0.90                            | \$ 0.92    | \$ 2.75                           | \$ 2.85      |

The supplemental pro forma information is presented for illustrative purposes only and may not be indicative of the consolidated results that would have actually been achieved by the Company. Furthermore, future results may vary significantly from the results reflected in the pro forma information. The pro forma results include adjustments primarily related to amortization of acquired intangible assets, depreciation of the fair value adjustment of acquisition-date plant assets, interest on borrowings and tax expense. In addition, nonrecurring adjustments to pro forma net income include \$270,000 of acquisition-related expenses and \$558,000 of expense related to the fair value adjustment of the acquisition date inventory; such expenses were excluded from 2013 pro forma net income and included in pro forma net income for the nine months ended September 30, 2012.

### 3. RECONCILIATIONS OF EQUITY

Below are reconciliations of total equity, Company equity and equity attributable to the noncontrolling interests for the nine months ended September 30, 2013 and 2012:

| <i>(In thousands)</i>                           | Total<br>Equity   | Stepan<br>Company<br>Equity | Noncontrolling<br>Interests<br>Equity <sup>(3)</sup> |
|---|-------------------|-----------------------------|--|
| Balance at January 1, 2013                      | \$ 480,880        | \$ 478,985                  | \$ 1,895   |
| Net income (loss)                               | 61,800            | 62,178                      | (378)  |
| Dividends                                       | (10,678)          | (10,678)                    |  |
| Common stock purchases <sup>(1)</sup>           | (3,334)           | (3,334)                     |  |
| Redemption of preferred stock                   | (21)              | (21)                        |  |
| Stock option exercises                          | 3,715             | 3,715                       |  |
| Defined benefit pension adjustments, net of tax | 2,538             | 2,538                       |  |
| Translation adjustments                         | (6,806)           | (6,840)                     | 34   |
| Derivative instrument activity, net of tax      | (18)              | (18)                        |  |
| Other <sup>(2)</sup>                            | 4,750             | 4,750                       |  |
| <b>Balance at September 30, 2013</b>            | <b>\$ 532,826</b> | <b>\$ 531,275</b>           | <b>\$ 1,551</b>                                      |

| <i>(In thousands)</i>  | Total<br>Equity   | Stepan<br>Company<br>Equity | Noncontrolling<br>Interests<br>Equity <sup>(3)</sup> |
|--|-------------------|-----------------------------|--|
| Balance at January 1, 2012   | \$ 405,465        | \$ 401,211                  | \$ 4,254   |
| Net income   | 64,194            | 63,957                      | 237  |
| Purchase of remaining interest in Stepan<br>Philippines, Inc. from noncontrolling interest | (2,000)           | 748                         | (2,748)  |
| Dividends  | (9,234)           | (9,234)                     |  |
| Common stock purchases <sup>(1)</sup>  | (5,408)           | (5,408)                     |  |
| Stock option exercises   | 4,645             | 4,645                       |  |
| Defined benefit pension adjustments, net of tax  | 1,676             | 1,676                       |  |
| Translation adjustments  | 3,493             | 3,431                       | 62   |
| Derivative instrument activity, net of tax   | 98                | 98                          |  |
| Other <sup>(2)</sup>   | 4,829             | 4,829                       |  |
| <b>Balance at September 30, 2012</b>   | <b>\$ 467,758</b> | <b>\$ 465,953</b>           | <b>\$ 1,805</b>                                      |

(1) Includes the value of Company shares purchased in the open market, the value of Company common shares tendered by employees to settle minimum statutory withholding taxes related to the receipt of performance awards and deferred compensation distributions, and the value of Company common shares tendered in lieu of cash for stock option exercises.

(2) Primarily comprised of activity related to stock-based compensation, deferred compensation and excess tax benefits.

(3)

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2013 includes noncontrolling interest in the Company's China joint venture. 2012 includes noncontrolling interests in the Company's China and Philippines joint ventures. The noncontrolling interest in the Philippines joint venture ended on March 22, 2012, when the Company purchased the remaining interest in that entity. See Note 17.

#### 4. FAIR VALUE MEASUREMENTS

The following are the financial instruments held by the Company at September 30, 2013 and December 31, 2012, and the methods and assumptions used to estimate the instruments' fair values:

##### *Cash and cash equivalents*

Carrying value approximates fair value because of the short maturity of the instruments.

##### *Derivative assets and liabilities*

Derivative assets and liabilities relate to the foreign currency exchange and interest rate contracts discussed in Note 5. Fair value and carrying value were the same because the contracts were recorded at fair value. The fair values of the foreign currency contracts were calculated as the difference between the applicable forward foreign exchange rates at the reporting date and the contracted foreign exchange rates multiplied by the contracted notional amounts. The fair values of the interest rate swaps were calculated as the difference between the contracted swap rate and the current market replacement swap rate multiplied by the present value of one basis point for the notional amount of the contract. See the table that follows the financial instrument descriptions for the reported fair values of derivative assets and liabilities.

##### *Long-term investments*

Long-term investments included the mutual fund assets the Company held at the reporting dates to fund a portion of its deferred compensation liabilities and all of its non-qualified supplemental executive defined contribution obligations (see the defined contribution plans section of Note 9). Fair value and carrying value were the same because the mutual fund assets were recorded at fair value in accordance with the fair value option rules set forth in the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 825, *Financial Instruments*. Fair values for the mutual funds were calculated using the published market price per unit at the reporting date multiplied by the number of units held at the reporting date. See the table that follows the financial instrument descriptions for the reported fair value of long-term investments.

##### *Debt obligations*

The fair value of debt with original maturities greater than one year comprised the combined present values of scheduled principal and interest payments for each of the various loans, individually discounted at rates equivalent to those which could be obtained by the Company for new debt issues with durations equal to the average life to maturity of each loan. The fair values of the remaining Company debt obligations approximated their carrying values due to the short-term nature of the debt. The Company's fair value measurements for debt fall in level 2 of the fair value hierarchy.

At September 30, 2013, and December 31, 2012, the fair value of debt and the related carrying values, including current maturities, were as follows:

| <i>(In thousands)</i> | September 30, 2013 | December 31, 2012 |
|-----------------------|--------------------|-------------------|
| Fair value            | \$ 286,643         | \$ 194,620        |
| Carrying value        | 276,805            | 182,402           |

The following tables present financial assets and liabilities measured on a recurring basis at fair value as of September 30, 2013, and December 31, 2012, and the level within the fair value hierarchy in which the fair value measurement falls:

| <i>(In thousands)</i>           | September<br>2013 | Level 1   | Level 2 | Level 3 |
|---------------------------------|-------------------|-----------|---------|---------|
| Mutual fund assets              | \$ 16,917         | \$ 16,917 | \$      | \$      |
| Derivative assets:              |                   |           |         |         |
| Foreign currency contracts      | 31                |           | 31      |         |
| Total assets at fair value      | \$ 16,948         | \$ 16,917 | \$ 31   | \$      |
| Derivative liabilities:         |                   |           |         |         |
| Foreign currency contracts      | \$ 30             | \$        | \$ 30   | \$      |
| Interest rate contracts         | 27                |           | 27      |         |
| Total liabilities at fair value | \$ 57             | \$        | \$ 57   | \$      |

| <i>(In thousands)</i>           | December<br>2012 | Level 1   | Level 2 | Level 3 |
|---------------------------------|------------------|-----------|---------|---------|
| Mutual fund assets              | \$ 14,093        | \$ 14,093 | \$      | \$      |
| Derivative assets:              |                  |           |         |         |
| Foreign currency contracts      | 67               |           | 67      |         |
| Total assets at fair value      | \$ 14,160        | \$ 14,093 | \$ 67   | \$      |
| Derivative liabilities:         |                  |           |         |         |
| Foreign currency contracts      | \$ 2             | \$        | \$ 2    | \$      |
| Interest rate contracts         | 57               |           | 57      |         |
| Total liabilities at fair value | \$ 59            | \$        | \$ 59   | \$      |



## 5. DERIVATIVE INSTRUMENTS

The Company is exposed to certain risks relating to its ongoing business operations. The primary risk managed by the use of derivative instruments is foreign currency exchange risk. The Company holds forward foreign currency exchange contracts that are not designated as any type of accounting hedge as defined by U.S. generally accepted accounting principles (although they are effectively economic hedges). The contracts are used to manage the Company's exposure to exchange rate fluctuations on certain Company subsidiary accounts receivable, accounts payable and other obligation balances that are denominated in currencies other than the entities' functional currencies. The forward foreign exchange contracts are recognized on the balance sheet as either an asset or a liability measured at fair value. Gains and losses arising from recording the foreign exchange contracts at fair value are reported in earnings as offsets to the losses and gains reported in earnings arising from the re-measurement of the receivable and payable balances into the applicable functional currencies. At September 30, 2013, and December 31, 2012, the Company had open forward foreign currency exchange contracts, with settlement dates of about one month, to buy or sell foreign currencies with a U.S. dollar equivalent of \$19,115,000 and \$16,258,000, respectively.

At times, the Company also holds forward foreign currency exchange contracts that are designated as a cash flow hedge. Most recently, the Company used these contracts to manage the risks and related cash flow variability resulting from exposure to exchange rate fluctuations on forecasted progress payments related to a construction project undertaken in Singapore. The progress payments were denominated in a currency other than the Singapore location's functional currency. The Company completed its hedging activity for the progress payments in September 2013. When in use, the forward foreign exchange contracts were recognized on the balance sheet as either an asset or a liability measured at fair value. Period-to-period changes in the fair value of the hedging instruments were recognized as gains or losses in other comprehensive income, to the extent effective. The accumulated gains and losses are being reclassified out of accumulated other comprehensive income (AOCI) into earnings in the periods over which the asset is being depreciated. The amount in AOCI at September 30, 2013, that is expected to be reclassified into earnings in the next 12 months is insignificant. The Company had no open forward foreign currency exchange contracts designated as cash flow hedges at September 30, 2013. At December 31, 2012, the Company had open forward foreign currency exchange contracts designated as cash flow hedges with U.S. dollar equivalent amounts of \$1,197,000.

The Company is exposed to volatility in short-term interest rates and mitigates certain portions of that risk by using interest rate swaps. The interest rate swaps are recognized on the balance sheet as either an asset or a liability measured at fair value. The Company held interest rate swap contracts with notional values of \$2,435,000 at September 30, 2013, and \$2,969,000 at December 31, 2012, which were designated as cash flow hedges. Period-to-period changes in the fair value of interest rate swap contracts are recognized as gains or losses in other comprehensive income, to the extent effective. As each interest rate swap hedge contract is settled, the corresponding gain or loss is reclassified out of AOCI into earnings in that settlement period. The latest date through which the Company expects to hedge its exposure to the volatility of short-term interest rates is March 31, 2015.

The fair values of the derivative instruments held by the Company on September 30, 2013, and December 31, 2012, and derivative instrument gains and losses for the three and nine month periods ended September 30, 2013 and 2012, were immaterial. For amounts reclassified out of AOCI into earnings for the three and nine months periods ended September 30, 2013 and 2012, see Note 11.

#### 6. STOCK-BASED COMPENSATION

On September 30, 2013, the Company had stock options outstanding under its 2000 Stock Option Plan, stock options and stock awards outstanding under its 2006 Incentive Compensation Plan and stock options, stock awards and stock appreciation rights (SARs) outstanding under its 2011 Incentive Compensation Plan.

Compensation expense/(income) recorded for all stock options, stock awards and SARs was as follows:

*(In thousands)*

| Three Months Ended |         | Nine Months Ended |       |
|--------------------|---------|-------------------|-------|
| September 30       |         | September 30      |       |
| 2013               | 2012    | 2013              | 2012  |
| \$996              | \$(842) | \$1,420           | \$749 |

The quarter-over-quarter and year-over-year increase in stock-based compensation expense primarily resulted from the 2012 third quarter assessment that the profitability targets for the performance awards that would vest on December 31, 2012, were not attainable. Consequently, previously accrued compensation expense for those awards was reversed.

Unrecognized compensation costs for stock options, stock awards and SARs was as follows:

| <i>(In thousands)</i> | September 30, 2013 | December 31, 2012 |
|-----------------------|--------------------|-------------------|
| Stock options         | \$ 995             | \$ 627            |
| Stock awards          | 2,386              | 1,669             |
| SARs                  | 1,428              | 815               |

The increase in unrecognized compensation costs for stock options, SARs and stock awards was primarily due to the first quarter 2013 grants of

|               | Shares |
|---------------|--------|
| Stock options | 50,087 |
| Stock awards  | 46,131 |
| SARs          | 88,548 |

The unrecognized compensation costs at September 30, 2013, are expected to be recognized over weighted-average periods of 1.2 years, 1.9 years and 1.3 years for stock options, stock awards and SARs, respectively.

## 7. INVENTORIES

The composition of inventories was as follows:

| <i>(In thousands)</i>    | September 30, 2013 | December 31, 2012 |
|--------------------------|--------------------|-------------------|
| Finished goods           | \$ 120,512         | \$ 113,589        |
| Raw materials            | 57,890             | 48,424            |
| <b>Total inventories</b> | <b>\$ 178,402</b>  | <b>\$ 162,013</b> |

Inventories are primarily priced using the last-in, first-out inventory valuation method. If the first-in, first-out inventory valuation method had been used for all inventories, inventory balances would have been approximately \$32,464,000 and \$33,868,000 higher than reported at September 30, 2013, and December 31, 2012, respectively.

## 8. CONTINGENCIES

There are a variety of legal proceedings pending or threatened against the Company. Some of these proceedings may result in fines, penalties, judgments or costs being assessed against the Company at some future time. The Company's operations are subject to extensive local, state and federal regulations, including the U.S. Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA) and the Superfund amendments of 1986 (Superfund). Over the years, the Company has received requests for information related to or has been named by the government as a potentially responsible party (PRP) at a number of waste disposal sites where clean up costs have been or may be incurred under CERCLA and similar state statutes. In addition, damages are being claimed against the Company in general liability actions for alleged personal injury or property damage in the case of some disposal and plant sites. The Company believes that it has made adequate provisions for the costs it may incur with respect to these sites.

At September 30, 2013, the Company has estimated a range of possible environmental and legal losses of \$9.8 million to \$29.0 million. At September 30, 2013, and December 31, 2012, the Company's accrued liability for such losses, which represented the Company's best estimate within the estimated range of possible environmental and legal losses, was \$14.8 million and \$15.4 million, respectively. During the nine months of 2013 cash outlays related to legal and environmental matters approximated \$1.8 million compared to \$2.2 million in the nine months of 2012.

For certain sites, the Company has responded to information requests made by federal, state or local government agencies but has received no response confirming or denying the Company's stated positions. As such, estimates of the total costs, or range of possible costs, of remediation, if any, or the Company's share of such costs, if any, cannot be determined with respect to these sites. Consequently, the Company is unable to predict the effect thereof on the Company's financial position, cash flows and results of operations. Given the information available, management believes the Company has no liability at these sites. However, in the event of one or more adverse determinations with respect to such sites in any annual or interim period, the effect on the Company's cash flows and results of operations for those periods could be material. Based upon the Company's present knowledge with respect to its involvement at these sites, the possibility of other viable entities' responsibilities for cleanup, and the extended period over which any costs would be incurred, the Company believes that these matters, individually and in the aggregate, will not have a material effect on the Company's financial position.

Following are summaries of the material contingencies at September 30, 2013:

***Maywood, New Jersey Site***

The Company's property in Maywood, New Jersey and property formerly owned by the Company adjacent to its current site and other nearby properties (Maywood site) were listed on the National Priorities List in September 1993 pursuant to the provisions of CERCLA because of certain alleged chemical contamination. Pursuant to an Administrative Order on Consent entered into between USEPA and the Company for property formerly owned by the Company, and the issuance of an order by USEPA to the Company for property currently owned by the Company, the Company has completed various Remedial Investigation Feasibility Studies (RI/FS), and has recorded a liability based on its best estimate of the remediation costs.

On August 23, 2013, USEPA issued a Feasibility Study and a Proposed Plan selecting remedies for soil remediation which, in some cases, may be different from those the Company used in determining its best estimate. The Proposed Plan is subject to an ongoing comment period. The Company continues to review the Proposed Plan and Feasibility Study in anticipation of responding to USEPA. Until such time as USEPA completes its remedy selection process, the Company does not know the scope of remediation that may be required. At this time, based on its current review and analysis of the Proposed Plan, the Company's recorded liability for claims associated with remediation of chemical contamination at the Maywood site represents its best estimate of the cost of remediation for the Maywood site. The estimated cost of such remediation could differ from the Company's current recorded liability, for example, if the Proposed Plan is adopted without any changes or based on the availability of additional information.

In addition, under the terms of a settlement agreement reached on November 12, 2004, the United States Department of Justice and the Company agreed to fulfill the terms of a Cooperative Agreement reached in 1985 under which the United States will take title to and responsibility for radioactive waste removal at the Maywood site, including past and future remediation costs incurred by the United States. As such, the Company recorded no liability related to this settlement agreement.

***D Imperio Property Site***

During the mid-1970's, Jerome Lightman and the Lightman Drum Company disposed of hazardous substances at several sites in New Jersey. The Company was named as a potentially responsible party (PRP) in the case *United States v. Lightman* (1:92-cv-4710 D.N.J.), which involved the D Imperio Property Site located in New Jersey. In 2012, the PRPs approved certain changes to remediation cost estimates which were considered in the Company's determination of its range of estimated possible losses and liability balance. The changes in range of possible losses and liability balance were immaterial.



Remediation work is continuing at this site. Based on current information, the Company believes that its recorded liability for claims associated with the D Imperio site is adequate. However, actual costs could differ from current estimates.

***Wilmington Site***

The Company is currently contractually obligated to contribute to the response costs associated with the Company's formerly-owned site at 51 Eames Street, Wilmington, Massachusetts. Remediation at this site is being managed by its current owner to whom the Company sold the property in 1980. Under the agreement, once total site remediation costs exceed certain levels, the Company is obligated to contribute up to five percent of future response costs associated with this site with no limitation on the ultimate amount of contributions. To date, the Company has paid the current owner \$2.2 million for the Company's portion of environmental response costs through the second quarter of 2013 (the current owner of the site bills the Company one calendar quarter in arrears). The Company has recorded a liability for its portion of the estimated remediation costs for the site. Depending on the ultimate cost of the remediation at this site, the amount for which the Company is liable could differ from the current estimates.

The Company and other prior owners also entered into an agreement in April 2004 waiving certain statute of limitations defenses for claims which may be filed by the Town of Wilmington, Massachusetts, in connection with this site. While the Company has denied any liability for any such claims, the Company agreed to this waiver while the parties continue to discuss the resolution of any potential claim which may be filed.

The Company believes that based on current information it has adequate reserves for the claims related to this site. However, depending on the ultimate cost of the remediation at this site, the amount for which the Company is liable could differ from the current estimates.

9. POSTRETIREMENT BENEFIT PLANSDefined Benefit Pension Plans

The Company sponsors various funded qualified and unfunded non-qualified defined benefit pension plans, the most significant of which cover employees in the U.S. and U.K. locations. The U.S. and U.K. defined benefit pension plans are frozen and service benefits are no longer being accrued.

**Components of Net Periodic Benefit Cost**

| <i>(In thousands)</i>          | <b>UNITED STATES</b>               |          |                                   |          |
|--------------------------------|------------------------------------|----------|-----------------------------------|----------|
|                                | Three Months Ended<br>September 30 |          | Nine Months Ended<br>September 30 |          |
|                                | 2013                               | 2012     | 2013                              | 2012     |
| Interest cost                  | \$ 1,604                           | \$ 1,689 | \$ 4,818                          | \$ 5,160 |
| Expected return on plan assets | (2,217)                            | (2,113)  | (6,621)                           | (6,318)  |
| Amortization of net loss       | 1,220                              | 817      | 3,832                             | 2,680    |
| Net periodic benefit cost      | \$ 607                             | \$ 393   | \$ 2,029                          | \$ 1,522 |

| <i>(In thousands)</i>          | <b>UNITED KINGDOM</b>              |        |                                   |        |
|--------------------------------|------------------------------------|--------|-----------------------------------|--------|
|                                | Three Months Ended<br>September 30 |        | Nine Months Ended<br>September 30 |        |
|                                | 2013                               | 2012   | 2013                              | 2012   |
| Interest cost                  | \$ 223                             | \$ 210 | \$ 667                            | \$ 629 |
| Expected return on plan assets | (234)                              | (223)  | (700)                             | (664)  |
| Amortization of net loss       | 71                                 | 13     | 213                               | 35     |
| Net periodic benefit cost      | \$ 60                              | \$     | \$ 180                            | \$     |

**Employer Contributions***U.S. Plans*

Due to a reduced minimum funding requirement precipitated by the Pension Funding Stabilization provision of the MAP-21 Act (Moving Ahead for Progress in the 21<sup>st</sup> Century Act) placed into law in 2012, the Company does not expect to make contributions to its funded U.S. qualified defined benefit pension plans in 2013. The Company expects to pay \$174,000 in 2013 related to its unfunded non-qualified plans. As of September 30, 2013, \$162,000 had been paid related to the non-qualified plans.

***U.K. Plan***

The Company's United Kingdom subsidiary expects to contribute approximately \$986,000 to its defined benefit pension plan in 2013. As of September 30, 2013, \$719,000 had been contributed to the plan.

**Defined Contribution Plans**

The Company sponsors retirement savings defined contribution plans that cover U.S. and U.K. employees. The Company also sponsors a qualified profit sharing plan for its U.S. employees. The retirement savings and profit sharing defined contribution plans include a qualified plan and a non-qualified supplemental executive plan.

Defined contribution plan expenses for the Company's retirement savings and profit sharing plans were as follows:

| <i>(In thousands)</i>                     | Three<br>Months Ended<br>September 30 |                 | Nine Months<br>Ended<br>September 30 |                 |
|---|---------------------------------------|-----------------|--------------------------------------|-----------------|
|   | 2013                                  | 2012            | 2013                                 | 2012            |
| Retirement savings plans                  | \$ 1,149                              | \$ 1,072        | \$ 3,316                             | \$ 3,184        |
| Profit sharing plan                       | 1,293                                 | 1,484           | 3,903                                | 4,365           |
| <b>Total defined contribution expense</b> | <b>\$ 2,442</b>                       | <b>\$ 2,556</b> | <b>\$ 7,219</b>                      | <b>\$ 7,549</b> |

The Company funds the obligations of its non-qualified supplemental executive defined contribution plans (supplemental plans) through a rabbi trust. The trust comprises various mutual fund investments selected by the participants of the supplemental plans. In accordance with the accounting guidance for rabbi trust arrangements, the assets of the trust and the obligations of the supplemental plans are reported on the Company's consolidated balance sheets. The Company elected the fair value option for the mutual fund investment assets so that offsetting changes in the mutual fund values and defined contribution plan obligations would be recorded in earnings in the same period. Therefore, the mutual funds are reported at fair value with any subsequent changes in fair value recorded in the statements of income. The liabilities related to the supplemental plans increase (i.e., supplemental plan expense is recognized) when the value of the trust assets appreciates and decrease when the value of the trust assets declines (i.e., supplemental plan income is recognized). At September 30, 2013, the balance of the trust assets was \$1,751,000, which equaled the balance of the supplemental plan liabilities (see the long-term investments section in Note 4 for further information regarding the Company's mutual fund assets).



**10. EARNINGS PER SHARE**

Below is the computation of basic and diluted earnings per share for the three and nine months ended September 30, 2013 and 2012. All share and per share data reflect the effects of the two-for-one common stock split that was effective December 14, 2012.

| <i>(In thousands, except per share amounts)</i>  | Three Months Ended |           | Nine Months Ended |           |
|--|--------------------|-----------|-------------------|-----------|
|  | September 30       |           | September 30      |           |
|  | 2013               | 2012      | 2013              | 2012      |
| <u>Computation of Basic Earnings per Share</u>   |                    |           |                   |           |
| Net income attributable to Stepan Company  | \$ 20,402          | \$ 20,230 | \$ 62,178         | \$ 63,957 |
| Deduct dividends on preferred stock  |                    | 178       | 43                | 533       |
| Income applicable to common stock  | \$ 20,402          | \$ 20,052 | \$ 62,135         | \$ 63,424 |
| Weighted-average number of common shares outstanding   | 22,700             | 21,162    | 22,576            | 21,106    |
| Basic earnings per share   | \$ 0.90            | \$ 0.95   | \$ 2.75           | \$ 3.01   |
| <u>Computation of Diluted Earnings per Share</u>   |                    |           |                   |           |
| Net income attributable to Stepan Company  | \$ 20,402          | \$ 20,230 | \$ 62,178         | \$ 63,957 |
| Weighted-average number of shares outstanding  | 22,700             | 21,162    | 22,576            | 21,106    |
| Add weighted-average net shares issuable from assumed exercise of options (under treasury stock method) <sup>(1)</sup> | 188                | 386       | 224               | 414       |
| Add weighted-average net shares related to unvested stock awards (under treasury stock method)                         | 8                  | 6         | 7                 | 6         |
| Add weighted-average shares issuable from assumed conversion of convertible preferred stock                            | 40                 | 1,182     | 107               | 1,182     |
| Weighted-average shares applicable to diluted earnings   | 22,936             | 22,736    | 22,914            | 22,708    |
| Diluted earnings per share   | \$ 0.89            | \$ 0.89   | \$ 2.71           | \$ 2.82   |

- <sup>(1)</sup> Options to purchase 52,068 and 50,540 shares of common stock were not included in the computations of dividend earnings per share for the three and nine months ended September 30, 2013, respectively. Options to purchase 21,924 shares of common stock were not included in the computations of diluted earnings per share for the nine months ended September 30, 2012. The options exercise prices were greater than the average market price for the common stock and their effect would have been antidilutive.

**11. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)**

Below is the change in the Company's accumulated other comprehensive income (loss) (AOCI) balance by component (net of income taxes) for the nine month period ended September 30, 2013:

| <i>(In thousands)</i>                               | Foreign<br>Currency<br>Translation<br>Adjustments | Defined<br>Benefit<br>Pension<br>Plan<br>Adjustments | Cash<br>Flow<br>Hedge<br>Adjustments | Total       |
|---|---|--|--------------------------------------|-------------|
| Balance at December 31, 2012                        | \$ (2,886)  | \$ (35,498)  | \$ 134                               | \$ (38,250) |
| Other comprehensive income before reclassifications | (6,840)   |  | (29)                                 | (6,869)     |
| Amounts reclassified from AOCI                      |   | 2,538  | 11                                   | 2,549       |
| Net current-period other comprehensive income       | (6,840)   | 2,538  | (18)                                 | (4,320)     |
| Balance at September 30, 2013                       | \$ (9,726)  | \$ (32,960)  | \$ 116                               | \$ (42,570) |

Information regarding reclassifications out of AOCI for the three and nine month periods ended September 30, 2013 and 2012, is displayed below:

| <i>(In thousands)</i>                                    | Amount Reclassified from AOCI <sup>(a)</sup> |          |                                   |            | Affected Line Item in<br>Consolidated Statements of<br>Income |
|--|--|----------|-----------------------------------|------------|---|
|  | Three Months Ended<br>September 30           |          | Nine Months Ended<br>September 30 |            |   |
| AOCI Components  | 2013   | 2012     | 2013                              | 2012       |   |
| Amortization of defined benefit pension actuarial losses | \$ (1,291)                                   | \$ (830) | \$ (4,045)                        | \$ (2,715) | (b)   |
|  | 481  | 318      | 1,507                             | 1,039      | Tax (expense) or benefit                                      |
|  | \$ (810)                                     | \$ (512) | \$ (2,538)                        | \$ (1,676) | Net of tax  |
| Gains and losses on cash flow hedges:                    |  |          |                                   |            |   |
| Interest rate contracts                                  | \$ (9)                                       | \$ (8)   | \$ (28)                           | \$ (17)    | Interest, net   |
| Foreign exchange contracts                               | 2  |          | 7                                 |            | Cost of sales   |
|  | (7)  | (8)      | (21)                              | (17)       | Total before tax  |
|  | 4  | 3        | 10                                | 5          | Tax (expense) or benefit                                      |
|  | \$ (3)                                       | \$ (5)   | \$ (11)                           | \$ (12)    | Net of tax  |
| Total reclassifications for the period                   | \$ (813)                                     | \$ (517) | \$ (2,549)                        | \$ (1,688) | Net of tax  |

(a) Amounts in parentheses denote expense to statement of income.

- (b) This component of accumulated other comprehensive income is included in the computation of net periodic benefit cost (see Note 9 for additional details).

## 12. SEGMENT REPORTING

The Company has three reportable segments: surfactants, polymers and specialty products. Segment operating results for the three and nine months ended September 30, 2013 and 2012, are summarized below:

| <i>(In thousands)</i>                                | Surfactants | Polymers   | Specialty Products | Segment Totals |
|--|-------------|------------|--------------------|----------------|
| <u>For the three months ended September 30, 2013</u> |             |            |                    |                |
| Net sales  | \$ 318,357  | \$ 137,649 | \$ 19,460          | \$ 475,466     |
| Operating income                                     | 24,094      | 19,076     | 1,311              | 44,481         |
| <u>For the three months ended September 30, 2012</u> |             |            |                    |                |
| Net sales  | \$ 313,076  | \$ 110,171 | \$ 17,731          | \$ 440,978     |
| Operating income                                     | 25,948      | 14,981     | 3,763              | 44,692         |
| <u>For the nine months ended September 30, 2013</u>  |             |            |                    |                |
| Net sales  | \$ 989,417  | \$ 354,972 | \$ 62,068          | \$ 1,406,457   |
| Operating income                                     | 79,712      | 43,364     | 8,340              | 131,416        |
| <u>For the nine months ended September 30, 2012</u>  |             |            |                    |                |
| Net sales  | \$ 995,346  | \$ 320,843 | \$ 60,289          | \$ 1,376,478   |
| Operating income                                     | 89,964      | 38,507     | 11,053             | 139,524        |

Below are reconciliations of segment operating income to consolidated income before income taxes:

| <i>(In thousands)</i>                         | Three Months Ended |              | Nine Months Ended |              |
|---|--------------------|--------------|-------------------|--------------|
|   | September 30       | September 30 | September 30      | September 30 |
|   | 2013               | 2012         | 2013              | 2012         |
| Operating income segment totals               | \$ 44,481          | \$ 44,692    | \$ 131,416        | \$ 139,524   |
| Unallocated corporate expenses <sup>(1)</sup> | (13,396)           | (10,801)     | (36,168)          | (35,412)     |
| Total operating income                        | 31,085             | 33,891       | 95,248            | 104,112      |
| Interest expense, net                         | (2,987)            | (2,684)      | (7,495)           | (7,374)      |
| Loss from equity in joint ventures            | (1,325)            | (1,376)      | (4,061)           | (3,817)      |
| Other, net                                    | 1,074              | 404          | 1,628             | 1,552        |
| Consolidated income before income taxes       | \$ 27,847          | \$ 30,235    | \$ 85,320         | \$ 94,473    |

- (1) Unallocated corporate expenses primarily comprise corporate administrative expenses (e.g., corporate finance, legal, human resources, information systems and deferred compensation) that are not included in segment operating income and not used to evaluate segment performance.

13. DEBT

At September 30, 2013, and December 31, 2012, debt comprised the following:

| <i>(In thousands)</i>                     | Maturity<br>Dates | September 30,<br>2013 | December 31,<br>2012 |
|---|-------------------|-----------------------|----------------------|
| <b>Unsecured private placement notes</b>  |                   |                       |                      |
| 3.86%                                     | 2019-2025         | \$ 100,000            | \$                   |
| 4.86%                                     | 2017-2023         | 65,000                | 65,000               |
| 5.88%                                     | 2016-2022         | 40,000                | 40,000               |
| 5.69%                                     | 2013-2018         | 34,286                | 34,286               |
| 6.86%                                     | 2013-2015         | 8,570                 | 12,856               |
| <b>Debt of foreign subsidiaries</b>       |                   |                       |                      |
| Secured bank term loans, foreign currency | 2013-2016         | 6,424                 | 9,531                |
| Secured bank term loan, U.S. dollars      |                   |                       | 3,500                |
| Unsecured bank debt, U.S. dollars         | 2014              | 1,000                 |                      |
| Unsecured bank debt, foreign currency     | 2014              | 690                   |                      |
| Other loans, foreign currency             | 2013-2015         | 20,835                | 17,229               |
| <b>Total debt</b>                         |                   | <b>\$ 276,805</b>     | <b>\$ 182,402</b>    |
| Less current maturities                   |                   | 35,230                | 32,838               |
| <b>Long-term debt</b>                     |                   | <b>\$ 241,575</b>     | <b>\$ 149,564</b>    |

On June 27, 2013, the Company completed a new \$100 million unsecured private placement loan with interest to be paid semi-annually and with equal annual principal payments beginning on June 27, 2019, and continuing through final maturity on June 27, 2025. The proceeds of this loan were used, in part, to finance the acquisition of BMS's North American polyester resins business (originally funded out of the Company's committed revolving credit agreement), with the balance to be used for capital expenditures and other corporate purposes. This loan agreement requires the maintenance of certain financial ratios and covenants that are substantially identical to the Company's existing long-term debt and customary events of default.

The Company has a committed \$125,000,000 multi-currency revolving credit agreement that expires in September 2017. The Company maintains standby letters of credit under its workers' compensation insurance agreements and for other purposes, as needed from time to time, which are issued under the revolving credit agreement. As of September 30, 2013, the Company had outstanding letters of credit totaling \$2,777,000 and no outstanding debt under this agreement. There was \$122,223,000 available under the revolving credit agreement as of September 30, 2013.

The various loan agreements contain provisions, which, among others, require maintenance of certain financial ratios and place limitations on additional debt, investments and payment of dividends. Based on the loan agreement provisions that place limitations on dividend payments, unrestricted retained earnings (i.e., retained earnings available for dividend distribution) were \$146,938,000 and \$114,204,000 at September 30, 2013, and December 31, 2012, respectively.

**14. OTHER, NET**

Other, net in the consolidated statements of income included the following:

| <i>(In thousands)</i>                       | Three Months Ended |          | Nine Months Ended |          |
|---|--------------------|----------|-------------------|----------|
|   | September 30       |          | September 30      |          |
|   | 2013               | 2012     | 2013              | 2012     |
| Foreign exchange loss                       | \$ (58)            | \$ (316) | \$ (668)          | \$ (196) |
| Investment income                           | 17                 | 13       | 110               | 31       |
| Realized and unrealized gain on investments | 1,115              | 707      | 2,186             | 1,717    |
| Other, net                                  | \$ 1,074           | \$ 404   | \$ 1,628          | \$ 1,552 |

**15. PREFERRED STOCK REDEMPTION**

On June 12, 2013, the Company announced that on August 9, 2013 (redemption date) it would redeem any remaining outstanding shares of its 5 ½ percent Convertible Preferred Stock without par value (preferred stock). At the time of the redemption announcement, there were 61,735 shares of preferred stock outstanding. Prior to the redemption date, preferred shareholders converted 60,900 shares of preferred stock into 139,029 shares of Company common stock. Pursuant to the redemption, stockholders tendered 835 shares of Company preferred stock for an aggregate redemption price of \$25.26354 per share (\$25.00 per share plus accrued and unpaid dividends of \$0.26354 per share). There are no longer any issued and outstanding shares of preferred stock.

**16. INSURANCE RECOVERY**

In August 2013, the Company received an insurance recovery of \$3,730,000 for business interruption losses resulting from a May 2011 fire that damaged polyol manufacturing equipment at the Company's plant site in Wesseling, Germany. The insurance recovery was recorded as a reduction of cost of sales in the condensed consolidated statements of income for the three and nine months ended September 30, 2013.

**17. PURCHASE OF THE REMAINING INTEREST IN STEPAN PHILIPPINES, INC.**

On March 22, 2012, the Company purchased the remaining interest in Stepan Philippines, Inc. (SPI) for \$2,000,000 of cash, increasing the Company's ownership share from 88.8 percent to 100 percent. As a result of this transaction, the Company's equity (additional paid-in capital) increased by \$551,000. In addition, \$197,000 of cumulative translation adjustments (gains) that previously had been allocated to the noncontrolling interest was reclassified to the Company's AOCI.

## 18. RECENT ACCOUNTING PRONOUNCEMENTS

In December 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-11, *Disclosures about Offsetting Assets and Liabilities*. Also, in January 2013, the FASB issued ASU No. 2013-01, *Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities*. These updates create new disclosure requirements about the nature of an entity's rights of setoff and related arrangements associated with its derivatives, repurchase agreements and securities lending transactions. Entities are required to apply the new disclosure requirements for annual and interim reporting periods beginning on or after January 1, 2013. Retrospective application is required. Adoption of the new requirements did not have an effect on the Company's financial position, results of operations or cash flows. In addition, because the Company does not have arrangements where rights of offset exist, adoption of the standard did not have an effect on Company disclosures.

In July 2012, the FASB issued ASU No. 2012-02, *Intangibles - Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment*. The amendments in this update aim to simplify the impairment test for indefinite-lived intangible assets by permitting an entity the option to assess qualitative factors to determine whether it is more likely than not (defined as having a likelihood of more than 50 percent) that an indefinite-lived intangible asset is impaired as a basis for determining whether the quantitative impairment test included in Accounting Standards Codification Subtopic 350-30, *Intangibles - Goodwill and Other - General Intangibles Other than Goodwill* must be performed. The amendment is effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012. The Company currently has no indefinite-lived intangible assets other than goodwill reported on its consolidated balance sheet. As such, adoption of this amendment did not have an effect on the Company's financial position, results of operations or cash flows.

In February 2013, the FASB issued ASU No. 2013-02, *Comprehensive Income (Topic 220): Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income*, which adds new disclosure requirements for items reclassified out of AOCI and expands the existing disclosure requirements for the presentation of changes in AOCI. The amendment is effective for reporting periods beginning after December 15, 2012. Because this update affects only the disclosures for AOCI, adoption of the requirements did not have an effect on the Company's financial position, results of operations or cash flows.

In February 2013, the FASB issued ASU No. 2013-04, *Liabilities (Topic 405), Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation is Fixed at the Reporting Date*. This update requires an entity to measure obligations resulting from joint and several liability arrangements for which the total amount of the obligation is fixed at the reporting date, as the sum of a) the amount the reporting entity agreed to pay on the basis of its arrangement among its co-obligors and b) any additional amount the reporting entity expects to pay on behalf of its co-obligors. The update also requires an entity to disclose the nature and amount of the obligation as well as other information about those obligations. The requirements of ASU No. 2013-04 are effective on a retrospective basis for interim and annual periods beginning after December 15, 2013. The Company is in the process of determining the effects, if any, that the adoption of ASU No. 2013-04 will have on the Company's financial position, results of operations or cash flows.

In July 2013, the FASB issued ASU No. 2013-11, *Income Taxes (Topic 740), Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*. The update clarifies that unrecognized tax benefits related to a net operating loss carryforward, or similar tax loss, or tax credit carryforward, should generally be presented in the financial statements as a reduction to a deferred tax asset. The requirements of ASU No. 2013-11 are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. The update allows for early adoption. The Company currently has no unrecognized tax benefits in jurisdictions where a net operating loss carryforward, or similar tax loss, or tax credit carryforward exists. The adoption of the new guidance is not expected to have a material impact on the Company's financial position, results of operations or cash flows.



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

The following is management's discussion and analysis (MD&A) of certain significant factors that have affected the Company's financial condition and results of operations during the interim period included in the accompanying condensed consolidated financial statements.

The matters discussed in the following discussion and analysis include forward-looking statements that are subject to certain risks, uncertainties and assumptions. Such forward-looking statements are intended to be identified in this document by the words, anticipate, believe, estimate, expect, intend, may, objective, outlook, plan, potential, should and similar expressions. Actual results may vary materially.

Forward-looking statements speak only as of the date they are made, and the Company does not undertake any obligation to update them to reflect changes that occur after that date. Factors that could cause actual results to differ materially include the items described in Item 1A of the Company's Annual Report on Form 10-K for the year ended December 31, 2012.

### Overview

The Company produces and sells intermediate chemicals that are used in a wide variety of applications worldwide. The overall business comprises three reportable segments:

**Surfactants** Surfactants, which accounted for 71 percent of consolidated net sales in the first nine months of 2013, are principal ingredients in consumer and industrial cleaning products such as detergents for washing clothes, dishes, carpets, floors and walls, as well as shampoos, body washes, toothpastes and fabric softeners. Other applications include germicidal quaternary compounds, lubricating ingredients, emulsifiers (for spreading agricultural products), plastics and composites and biodiesel. Surfactants are manufactured at six North American sites (five in the U.S. and one in Canada), three European sites (United Kingdom, France and Germany), three Latin American sites (Mexico, Brazil and Colombia) and two Asian sites (Philippines and Singapore). The Company also holds a 50 percent ownership interest in a joint venture, TIORCO, LLC (TIORCO), that markets chemical solutions for increasing the production of crude oil and natural gas from existing fields (enhanced oil recovery or EOR). The joint venture is accounted for under the equity method, and its financial results are excluded from surfactant segment operating results. Profits on sales of the Company's surfactants to enhanced oil recovery customers are included in surfactants segment results.

**Polymers** Polymers, which accounted for 25 percent of consolidated net sales in the first nine months of 2013, include two primary product lines: polyols and phthalic anhydride. Polyols are used in the manufacture of rigid laminate insulation board and panels for thermal insulation in the construction industry and are also a base raw material for flexible foams and coatings, adhesives, sealants and elastomers (collectively CASE products). Phthalic anhydride is used in unsaturated polyester resins, alkyd resins and plasticizers for applications in construction materials and components of automotive, boating and other consumer products. In addition, the Company uses phthalic anhydride internally in the production of polyols. In the U.S., polymer product lines are manufactured at the Company's Millsdale, Illinois, site and beginning June 1, 2013, at the Company's Columbus, Georgia, site (see the Acquisition section for information regarding the Company's June 1, 2013, acquisition). In Europe, polyols are manufactured at the Company's subsidiaries in Germany and Poland. In Asia, polyols are currently toll produced for the Company's 80-percent owned joint venture in Nanjing, China (see the Segment Results section of this MD&A for a discussion regarding the Company's requirement to move its China facility).



**Specialty Products** Specialty products, which accounted for four percent of consolidated net sales in the first nine months of 2013, include flavors, emulsifiers and solubilizers used in the food, nutritional supplement and pharmaceutical industries. Specialty products are primarily manufactured at the Company's Maywood, New Jersey, site and, in some instances, at outside contractors.

*Acquisition*

On June 1, 2013, the Company announced it had acquired the North American polyester resins business of Bayer MaterialScience LLC (BMS). Prior to the acquisition, BMS was a leading North American producer of powder polyester resins for metal coating applications and liquid polyester resins for CASE applications. The acquisition included a 21,000-ton production facility in Columbus, Georgia, and a modern research and development laboratory for customer technical support and new product development. Infrastructure is in place to allow for future expansion. Prior to the purchase, the acquired business had annual sales of approximately \$64 million. As of the acquisition date, the new business became a part of the North American operations reporting unit included in the Company's polymers reportable segment.

The acquisition has diversified the Company's polyol product offering and is expected to accelerate Company growth in CASE and PUSH (polyurethane systems house) applications. The Company intends to make future capital expenditures to expand production capabilities at the site.

The total acquisition purchase price was \$68,212,000 cash, of which \$61,067,000 was paid at closing with \$7,145,000 primarily for inventory paid over a three-month period (June 2013 through August 2013) pursuant to a transition services agreement with BMS. The acquisition was originally funded through the Company's committed revolving credit agreement. Subsequent to closing on the acquisition, the Company completed a \$100.0 million private placement loan, which was used in part to finance the acquisition (see the Liquidity and Capital Resources section of this MD&A for further information regarding the private placement borrowing).

The effect of the new business was immaterial to the Company's earnings for the three and nine month periods ended September 30, 2013. The Company believes that the acquisition will be slightly accretive to 2013 earnings. See Note 2 of the condensed consolidated financial statements for further details regarding the acquisition.

*Deferred Compensation Plans*

The accounting for the Company's deferred compensation plans can cause period-to-period fluctuations in Company expenses and profits. Compensation expense results when the values of Company common stock and mutual fund investment assets held for the plans increase, and compensation income results when the values of Company common stock and mutual fund investment assets decline. The pretax effect of all deferred compensation-related activities (including realized and unrealized gains and losses on the mutual fund assets held to fund the deferred compensation obligations) and the income statement line items in which the effects of the activities were recorded are displayed in the following table:

| <i>(In millions)</i>                                  | Income (Expense)<br>For the Three Months<br>Ended September 30 |          |                         |
|---|--|----------|-------------------------|
|   | 2013   | 2012     | Change                  |
| Deferred Compensation (Administrative expense)        | \$ (2.2)   | \$ (1.3) | \$ (0.9) <sup>(1)</sup> |
| Realized/Unrealized Gains on Investments (Other, net) | 1.1  | 0.7      | 0.4                     |
| Investment Income (Other, net)                        |  |          |                         |
| Pretax Income Effect                                  | \$ (1.1)   | \$ (0.6) | \$ (0.5)                |

| <i>(In millions)</i>                                  | Income (Expense)<br>For the Nine Months<br>Ended September 30 |          |                       |
|---|---|----------|-----------------------|
|   | 2013  | 2012     | Change                |
| Deferred Compensation (Administrative expense)        | \$ (3.5)  | \$ (6.3) | \$ 2.8 <sup>(1)</sup> |
| Realized/Unrealized Gains on Investments (Other, net) | 2.1   | 1.7      | 0.4                   |
| Investment Income (Other, net)                        | 0.1   |          | 0.1                   |
| Pretax Income Effect                                  | \$ (1.3)  | \$ (4.6) | \$ 3.3                |

<sup>(1)</sup> See the Corporate Expenses section of this management's discussion and analysis for details regarding the quarter-over-quarter and year-over-year changes in deferred compensation expense.

*Effects of Foreign Currency Translation*

The Company's foreign subsidiaries transact business and report financial results in their respective local currencies. As a result, foreign subsidiary income statements are translated into U.S. dollars at average foreign exchange rates appropriate for the reporting period. Because foreign exchange rates fluctuate against the U.S. dollar over time, foreign currency translation affects period-to-period comparisons of financial statement items (i.e., because foreign exchange rates fluctuate, similar period-to-period local currency results for a foreign subsidiary may translate into different U.S. dollar results). The following tables present the effects that foreign currency translation had on the period-over-period changes in consolidated net sales and various income line items for the three and nine month periods ended September 30, 2013 and 2012:

| <i>(In millions)</i> | Three Months Ended |          | Increase               |                               |
|----------------------|--------------------|----------|------------------------|-------------------------------|
|                      | September 30       |          | Increase<br>(Decrease) | Due to Foreign<br>Translation |
|                      | 2013               | 2012     |                        |                               |
| Net Sales            | \$ 475.5           | \$ 441.0 | \$ 34.5                | \$ 0.9                        |
| Gross Profit         | 74.3               | 71.2     | 3.1                    | 0.2                           |
| Operating Income     | 31.1               | 33.9     | (2.8)                  | 0.1                           |
| Pretax Income        | 27.8               | 30.2     | (2.4)                  | 0.2                           |

| <i>(In millions)</i> | Nine Months Ended |            | Increase               |                               |
|----------------------|-------------------|------------|------------------------|-------------------------------|
|                      | September 30      |            | Increase<br>(Decrease) | Due to Foreign<br>Translation |
|                      | 2013              | 2012       |                        |                               |
| Net Sales            | \$ 1,406.5        | \$ 1,376.5 | \$ 30.0                | \$ 2.1                        |
| Gross Profit         | 220.7             | 221.4      | (0.7)                  | 0.1                           |
| Operating Income     | 95.2              | 104.1      | (8.9)                  | 0.1                           |
| Pretax Income        | 85.3              | 94.5       | (9.2)                  | 0.2                           |

## RESULTS OF OPERATIONS

Three Months Ended September 30, 2013 and 2012**Summary**

Net income attributable to the Company for the third quarter of 2013 increased one percent quarter-over-quarter to \$20.4 million, or \$0.89 per diluted share, compared to \$20.2 million, or \$0.89 per diluted share, for the third quarter of 2012 (all per share data reflect the effects of the two-for-one common stock split that was effective December 14, 2012). Below is a summary discussion of the major factors leading to the quarter-over-quarter changes in net sales, profits and expenses. A detailed discussion of segment operating performance for the second quarter of 2013 follows the summary.

Consolidated net sales increased \$34.5 million, or eight percent, quarter over quarter. A nine percent increase in sales volume and the favorable effects of foreign currency translation increased net sales by \$41.4 million and \$0.9 million, respectively. The surfactants and polymers segments accounted for most of the sales volume improvement, growing seven percent and 19 percent, respectively. A decline in average selling prices reduced the effect of increased sales volume and foreign currency translation by \$7.8 million. Quarter-over-quarter declines in surfactant raw material costs drove the decline in average selling prices.



Operating income for the third quarter of 2013 declined \$2.8 million, or eight percent, from operating income reported for the third quarter of 2012. Gross profit was up \$3.1 million, or four percent, between quarters. Polymers segment gross profit improved, while the surfactants and specialty products segments posted lower profits. Polymers gross profit gain was largely driven by improvement for European operations and benefited from a \$3.7 million insurance recovery. The decline in surfactants segment gross profit was principally attributable to North American operations where higher priced methyl ester inventories built up in prior periods to support the Singapore start-up combined with contractual selling price lags had a negative impact on margins. The North American decline was partially offset by positive contribution from the Singapore plant. Reduced margins for medium-chain triglyceride products used in food ingredient applications hurt the specialty products quarter-over-quarter results.

Operating expenses increased \$5.9 million, or 16 percent, between quarters. The following summarizes the quarter-over-quarter changes in the individual income statement line items that comprise the Company's operating expenses:

Selling expenses increased \$0.7 million, or six percent, quarter over quarter. The only item of note was a \$0.3 million increase related to the Company's provisions for bad debts, which primarily related to general weakness in the European economy.

Administrative expenses increased \$3.7 million, or 26 percent, quarter over quarter. Higher Asia operation expenses (\$1.0 million) and increased expenses for deferred compensation (\$0.9 million), corporate and other Company entity legal (\$0.8 million) and salaries and the related fringe benefits (\$0.7 million) accounted for the change in administrative expenses. The higher quarter-over-quarter expenses for Asia operations included a \$0.7 million charge related to the Company's China joint venture obligation to dismantle and remove the assets at its Nanjing, China, polymer plant. The increase in deferred compensation expense resulted from a greater increase in the value of Company common stock for the third quarter of 2013 than for the same quarter of 2012 (See the Overview and Corporate Expenses sections of this MD&A for further details). The rise in legal and salary-related expenses reflected additional spending to support the Company's growth and innovation initiatives.

Research, development and technical service expenses were up \$1.4 million, or 13 percent, quarter over quarter. Higher U.S. salary expenses and the related fringe benefits accounted for \$0.6 million of the increase. Product registration under Europe's REACH (Registration, Evaluation, Authorisation and Restriction of Chemicals) regulation and outside contract services accounted for \$0.3 million and \$0.2 million, of additional expenses, respectively.

Net interest expense for the third quarter of 2013 increased \$0.3 million over net interest expense for the third quarter of 2012. The increase reflected higher average debt levels. On June 27, 2013, the Company borrowed \$100.0 million pursuant to a private placement note purchase agreement that expires in 2025. The Company borrowed the funds primarily to finance the second quarter acquisition of the North American polyester resins business of BMS and expects to use the remaining proceeds for related capital expenditures and working capital as well as for general corporate purposes.

Other, net was \$1.1 million of income for the third quarter of 2013 compared to \$0.4 million of income for the same period of 2012. Net investment income (including realized and unrealized gains and losses) for the Company's deferred compensation and supplemental defined contribution mutual fund assets was up \$0.4 million quarter over quarter. Foreign exchange losses amounted to less than \$0.1 million for the third quarter of 2013 compared to \$0.3 million for the third quarter 2012.

The effective tax rate was 27.6 percent for the third quarter of 2013 compared to 32.8 percent for the third quarter of 2012. The decrease was primarily attributable to a greater percentage of consolidated income being generated outside the U.S. where the effective tax rates are lower. Also contributing to the effective tax rate decline was the federal research and development tax credit and the small agri-biodiesel producer tax credit which were extended retroactively from January 1, 2012 through December 31, 2013 when *The American Taxpayer Relief Act of 2012* was signed into law on January 2, 2013. As a result of this legislation, the Company recorded a tax benefit of \$0.5 million for amounts generated in the third quarter of 2013. For the first three quarters of 2013 the tax benefit related to the legislation was \$2.6 million, of which \$1.4 million related to 2012 (recorded in the first quarter of 2013).

### Segment Results

| <i>(In thousands)</i>                                | Surfactants | Polymers   | Specialty Products | Segment Results | Corporate | Total      |
|--|-------------|------------|--------------------|-----------------|-----------|------------|
| <u>For the three months ended September 30, 2013</u> |             |            |                    |                 |           |            |
| Net sales  | \$ 318,357  | \$ 137,649 | \$ 19,460          | \$ 475,466      |           | \$ 475,466 |
| Operating income                                     | 24,094      | 19,076     | 1,311              | 44,481          | (13,396)  | 31,085     |
| <u>For the three months ended September 30, 2012</u> |             |            |                    |                 |           |            |
| Net sales  | \$ 313,076  | \$ 110,171 | \$ 17,731          | \$ 440,978      |           | \$ 440,978 |
| Operating income                                     | 25,948      | 14,981     | 3,763              | 44,692          | (10,801)  | 33,891     |

#### Surfactants

Surfactants net sales for the third quarter of 2013 increased \$5.3 million, or two percent, over net sales for the third quarter of 2012. A seven percent increase in sales volume drove the net sales improvement. All regions contributed to the higher sales volume, which favorably affected the quarter-over-quarter increase in net sales by \$22.5 million. Lower average selling prices, precipitated by reduced raw material costs, and the unfavorable effects of foreign currency translation offset the impact of sales volume by \$16.3 million and \$0.9 million, respectively. A quarter-over-quarter comparison of net sales by region follows:

| <i>(In thousands)</i>            | For the Three Months Ended |                       | Increase<br>(Decrease) | Percent<br>Change |
|----------------------------------|----------------------------|-----------------------|------------------------|-------------------|
|                                  | September 30,<br>2013      | September 30,<br>2012 |                        |                   |
| North America                    | \$ 186,148                 | \$ 190,949            | \$ (4,801)             | -3                |
| Europe                           | 69,513                     | 64,977                | 4,536                  | +7                |
| Latin America                    | 41,241                     | 41,245                | (4)                    |                   |
| Asia                             | 21,455                     | 15,905                | 5,550                  | +35               |
| <b>Total Surfactants Segment</b> | <b>\$ 318,357</b>          | <b>\$ 313,076</b>     | <b>\$ 5,281</b>        | <b>+2</b>         |





Net sales for North American operations declined three percent quarter over quarter. Sales volume increased one percent due to higher sales of laundry and cleaning products and increased demand from distributors, partially offset by weak demand for products used in oilfield and enhanced oil recovery applications. A four percent decrease in average selling prices, brought on by lower quarter-over-quarter raw material costs, more than offset the effect of increased sales volume. The decrease in average selling prices accounted for \$7.0 million of the net sales decline. The increase in sales volume offset the impact of reduced selling prices by \$2.7 million. The effects of foreign currency translation negatively affected the net sales change by \$0.5 million.

Net sales for European operations increased seven percent between quarters due to a 12 percent increase in sales volume, which had a \$7.7 million favorable effect. Much of the volume improvement resulted from increased sales of products used in consumer product applications (i.e., laundry and cleaning, personal care and household, institutional and industry products). Stronger demand from existing customers and new business accounted for the increase in consumer product sales. Also contributing to Europe's sales volume gain was increased demand from most major distributors and agricultural chemical customers. A seven percent decline in average selling prices, which reflected a decrease in raw material costs, offset the impact of higher sales volume by \$5.2 million. The favorable effects of foreign currency translation added \$2.0 million to the quarter-over-quarter net sales increase.

Net sales for Latin American operations were unchanged quarter over quarter. A nine percent increase in sales volume was offset by a four percent drop in average selling prices and the unfavorable effects of foreign currency translation. Most of the sales volume improvement was generated by the Company's Brazil subsidiary, which posted an 11 percent quarter-over-quarter volume increase, as the Company continued to grow its surfactants business in that country. The improved sales volume had a \$3.7 million favorable impact on the quarter-over-quarter net sales change. The decline in average selling prices offset the effect of sales volume by \$1.8 million. Lower raw material costs led to the selling price decrease. The effects of foreign currency translation reduced quarter-over-quarter net sales by \$1.9 million. A weakening of the Brazilian real against the U.S. dollar caused the translation effect.

Net sales for Asia operations improved 35 percent due to a 38 percent increase in sales volume. The Company's Singapore subsidiary accounted for the increase as that location was not commercially operational until the fourth quarter of 2012.

Surfactants operating income for the third quarter of 2013 declined \$1.9 million, or seven percent, from operating income for the third quarter of 2012. Gross profit decreased \$1.0 million due to a decline in profit for North American operations, which was partially offset by increased gross profit for Asia operations. Operating expenses increased \$0.8 million, or four percent. Quarter-over-quarter comparisons of gross profit by region and total segment operating expenses and operating income follow:

| <i>(In thousands)</i>     | For the Three Months<br>Ended |                       | Increase<br>(Decrease) | Percent<br>Change |
|---------------------------|-------------------------------|-----------------------|------------------------|-------------------|
|                           | September 30,<br>2013         | September 30,<br>2012 |                        |                   |
| <u>Gross Profit</u>       |                               |                       |                        |                   |
| North America             | \$ 29,364                     | \$ 35,792             | \$ (6,428)             | -18               |
| Europe                    | 5,149                         | 4,592                 | 557                    | +12               |
| Latin America             | 5,325                         | 5,233                 | 92                     | +2                |
| Asia                      | 5,211                         | 481                   | 4,730                  | +NM               |
| Total Surfactants Segment | \$ 45,049                     | \$ 46,098             | \$ (1,049)             | -2                |
| Operating Expenses        | 20,955                        | 20,150                | 805                    | +4                |
| Operating Income          | \$ 24,094                     | \$ 25,948             | \$ (1,854)             | -7                |

North American gross profit declined 18 percent quarter over quarter due to a decline in average unit margins precipitated by the consumption of high priced methyl ester inventories (built in prior periods to support the Singapore start-up), contractual selling price lags and increased competitive activity. An unfavorable mix of product sales (reduced sales of oilfield chemicals and increased sales of laundry and cleaning) also contributed to the decreased margin.

Gross profit for European operations improved 12 percent due to the previously noted 12 percent increase in sales volume.

Gross profit for Latin American operations increased two percent due to the nine percent increase in sales volume largely offset by a \$0.4 million unfavorable effect of foreign currency translation.

Asia operations gross profit improvement was principally the result of the Singapore subsidiary's contribution. The location was not commercially operational in the third quarter of 2012.

Operating expenses for the surfactants segment were up \$0.8 million, or four percent, between quarters. Research and development and selling expenses accounted for \$0.5 million and \$0.2 million, respectively, of the increase. Higher salary and fringe benefit expenses for North American operations were a significant factor in both the increased research and development and selling expenses. Higher quarter-over-quarter expenditures for European product registration also contributed to the rise in research and development costs.

### *Polymers*

Polymers net sales for the third quarter of 2013 increased \$27.5 million, or 25 percent, over net sales for the same quarter of 2012. A 19 percent increase in sales volume, higher average selling prices and the favorable effects of foreign currency translation accounted for \$21.0 million, \$4.9 million and \$1.6 million, respectively, of the net sales improvement. The current quarter benefited from the BMS North American polyester resins acquisition made in June, as the acquired business contributed \$13.7 million and 40 percent of the changes in net sales and sales volume, respectively. A quarter-over-quarter comparison of net sales by region is displayed below:

| <i>(In thousands)</i>  | For the Three Months Ended |                    |           | Percent Change |
|------------------------|----------------------------|--------------------|-----------|----------------|
|                        | September 30, 2013         | September 30, 2012 | Increase  |                |
| North America          | \$ 84,096                  | \$ 68,572          | \$ 15,524 | +23            |
| Europe                 | 45,981                     | 34,383             | 11,598    | +34            |
| Asia and Other         | 7,572                      | 7,216              | 356       | +5             |
| Total Polymers Segment | \$ 137,649                 | \$ 110,171         | \$ 27,478 | +25            |

Net sales for North American operations increased 23 percent between quarters on sales volume that was up 17 percent. The increases in net sales and sales volume were largely attributable to the contribution of the BMS North American polyester resins acquisition made in June. The acquired business accounted for \$13.7 million and 74 percent of the quarter-over-quarter changes in net sales and sales volume, respectively. Net sales for the Company's pre-acquisition polymer business increased \$1.8 million on sales volume that was essentially unchanged. Phthalic anhydride sales volume was up slightly but was offset by a small decrease in polyol sales volume.

Net sales for European operations increased 34 percent due to a 29 percent increase in sales volume and the effects of foreign currency translation, which accounted for \$9.8 million and \$1.4 million, respectively, of the net sales improvement. The increase in sales volume reflected the Company's success in securing additional business at a number of major polyol customers, despite an uncertain European economy. Average selling prices increased one percent, which positively affected the quarter-over-quarter increase in net sales by \$0.4 million.

Net sales for Asia and Other operations increased five percent quarter over quarter due to the effects of a favorable customer mix that more than offset a seven percent decline in sales volume. The decline in sales volume reflected a weaker economy in China and some lost business due to competitive activity.

As noted in prior filings, local government officials in Nanjing, China, have informed the Company that its manufacturing facility in that city will need to be relocated. The existing China plant is no longer producing. Customers' requirements are being sourced from inventory produced in advance of the shutdown and from the Company's U.S. and European plants and toll production in China, which negatively affects profit.

Polymer operating income for the third quarter of 2013 increased \$4.1 million, or 27 percent, over operating income for the same quarter of 2012. Gross profit improved \$6.1 million, largely due to improvement for European operations. The current quarter benefited from the receipt of a \$3.7 million business interruption insurance recovery for lost business resulting from a 2011 fire that damaged polyol equipment at the Germany site. Operating expenses increased \$2.0 million, or 36 percent. 2013 operating expenses included \$0.7 million of estimated demolition costs for the China manufacturing plant. Quarter-over-quarter comparisons of gross profit by region and total segment operating expenses and operating income follow:

| <i>(In thousands)</i>         | For the Three Months Ended |                       | Increase<br>(Decrease) | Percent<br>Change |
|-------------------------------|----------------------------|-----------------------|------------------------|-------------------|
|                               | September 30,<br>2013      | September 30,<br>2012 |                        |                   |
| <u>Gross Profit</u>           |                            |                       |                        |                   |
| North America                 | \$ 15,875                  | \$ 15,547             | \$ 328                 | +2                |
| Europe                        | 10,411                     | 3,988                 | 6,423                  | +161              |
| Asia and Other                | 274                        | 932                   | (658)                  | -71               |
| <b>Total Polymers Segment</b> | <b>\$ 26,560</b>           | <b>\$ 20,467</b>      | <b>\$ 6,093</b>        | <b>+30</b>        |
| Operating Expenses            | 7,484                      | 5,486                 | 1,998                  | +36               |
| <b>Operating Income</b>       | <b>\$ 19,076</b>           | <b>\$ 14,981</b>      | <b>\$ 4,095</b>        | <b>+27</b>        |

Gross profit for North American operations increased two percent quarter over quarter. Improved margins for polyols used in insulation applications and the acquired BMS business increased quarter-over-quarter gross profit. Gross profit for third quarter of 2012 greatly benefited from a large sale of a urethane systems product used in a new aircraft carrier. There were no such sales in 2013, which negatively impacted the quarter-over-change in gross profit.

The increase in gross profit for European operations was primarily driven by the previously mentioned \$3.7 million insurance recovery and the 29 percent improvement in sales volume. Increased unit margins and the favorable effects of foreign currency also contributed.

The decline in gross profit for Asia and Other operations was due to reduced selling margins and the decline in sales volume. Outsourcing for the China location as opposed to manufacturing product led to the reduced margins.

Polymer operating expenses increased \$2.0 million, or 36 percent, quarter over quarter. Included in the 2013 expenses was a \$0.7 million charge for estimated dismantling costs for the manufacturing site in Nanjing, China. The majority of the remaining operating expense increase was attributable to higher selling (\$0.6 million) and research and development (\$0.5 million) expenses. Higher bad debt provisions, primarily for European customers, accounted for \$0.3 million of the increased selling expenses. Higher salary and the related fringe benefit expenses were the major contributors to the increased research and development expenses.

### *Specialty Products*

Net sales for the third quarter of 2013 increased \$1.7 million, or 10 percent, over net sales for the third quarter of 2012. Operating income declined \$2.5 million due to an unfavorable mix of sales and to higher raw material costs and manufacturing and operating expenses, especially for the Company's medium-chain triglycerides that are used in food ingredient applications.

### *Corporate Expenses*

Corporate expenses, which comprise operating expenses that are not allocated to the reportable segments, increased \$2.6 million to \$13.4 million for the third quarter of 2013 from \$10.8 million for the third quarter of 2012. The quarter-over-quarter growth in corporate expenses was principally attributable to increased expenses for deferred compensation (\$0.9 million), salaries and related fringe benefits (\$0.7 million) and legal (\$0.6 million).

Deferred compensation expenses increased to \$2.2 million in the third quarter of 2013 from \$1.3 million for the same quarter of last year. Most of the increase reflected a greater rise in Company common stock value in the third quarter of 2013 than in the third quarter of 2012 (\$2.12 per share increase in 2013 compared to \$0.97 per share increase in 2012). The following table presents the quarter-end Company common stock prices used in the computation of deferred compensation expense:

|                     | 2013         |          | 2012         |          |
|---------------------|--------------|----------|--------------|----------|
|                     | September 30 | June 30  | September 30 | June 30  |
| Company Stock Price | \$ 57.73     | \$ 55.61 | \$ 48.06     | \$ 47.09 |

The increase in salaries and fringe benefits reflected planned increases in personnel for 2013 and annual pay increases. In addition, expenses for the third quarter of 2012 included favorable adjustments to stock compensation (revised assessment regarding achievability of performance award targets) that did not recur in the third quarter of 2013. The increase in corporate legal expenses was largely due to additional spending to support the Company's growth and innovation initiatives.

#### Nine Months Ended September 30, 2013 and 2012

##### *Summary*

Net income attributable to the Company for the first three quarters of 2013 declined three percent to \$62.2 million, or \$2.71 per diluted share, compared to \$64.0 million, or \$2.82 per diluted share, for the first three quarters of 2012 (all per share data reflect the effects of the two-for-one common stock split that was effective December 14, 2012). Below is a summary discussion of the major factors leading to the year-over-year changes in net sales, profits and expenses. A detailed discussion of segment operating performance for the first three quarters of 2013 follows the summary.

Consolidated net sales increased \$30.0 million, or two percent, year over year due to a five percent improvement in sales volume and to the favorable effects of foreign currency translation, which accounted for \$73.2 million and \$2.1 million, respectively, of the net sales increase. Sales volumes for the surfactants and polymers segments improved six percent and five percent, respectively. Sales volume for the specialty products segment was down three percent. A decline in average selling prices had a \$45.3 million unfavorable impact on the year-over-year net sales change. Decreased raw material costs for surfactants led to the drop in average selling prices.

Operating income for the first three quarters of 2013 declined \$8.9 million, or nine percent, from operating income for the first three quarters of 2012. Gross profit decreased \$0.7 million, or less than one percent. The polymers segment reported higher year-over-year gross profit, but the improvement was more than offset by gross profit declines for the surfactants and specialty products segments. Higher profits, largely due to greater sales volume, for European and North American operations led to the polymers result. In addition, 2013 European profits benefited from the receipt of a \$3.7 million insurance recovery. Margin deterioration for the Company's North American operations negatively impacted surfactants gross profit. Specialty products profits were negatively impacted by lower sales volumes and lower margins for medium-chain triglyceride products used in food ingredient applications.

Operating expenses increased \$8.2 million, or seven percent, between years. The following summarizes the year-over-year changes in the individual income statement line items that comprise the Company's operating expenses:

Selling expenses increased \$2.3 million, or six percent, year over year. A number of small expense items led to the higher consolidated selling expenses, including increased bad debt expense (\$0.6 million), European personnel costs (\$0.4 million), Brazil sales office rent (\$0.3 million) and product registration expenses for Singapore methyl esters (\$0.2 million). In addition, the prior year included royalty income (\$0.3 million) that did not recur in 2013. The year-over-year increase in bad debt expense was due to general weakness in the European economy and to favorable adjustments made for North American operations in 2012.

Administrative expenses increased \$3.6 million, or eight percent, year over year. Expenses for Asia operations were up \$1.6 million as the Company continued to invest in personnel and other resources to support Company growth initiatives in that region of the world. In addition, Asia operations administrative expenses included a \$0.7 million charge for estimated dismantling costs for the manufacturing site in Nanjing, China. Other major contributors to the increase in consolidated administrative expenses included higher expenses for salaries and the related fringe benefits (\$1.8 million), corporate and other Company entity legal (\$1.8 million), hardware and software maintenance (\$0.4 million) and U.S. expatriate support (\$0.4 million).

The above increases were partially offset by a \$2.8 million year-over-year decline in deferred compensation expense. The decline reflected a smaller year-over-year increase in the value of Company stock. See the [Overview](#) and [Corporate Expenses](#) sections of this MD&A for further details.

Research, development and technical service (R&D) expenses were up \$2.3 million, or seven percent, year over year. Higher U.S. salary and related fringe benefit expenses (\$0.9 million), European product registration expenses (\$0.7 million) and expenses for outside contracted services (\$0.4 million) were the largest contributors to the rise in R&D expenses. The higher salary and fringe benefit expenses reflected increased personnel to pursue the Company's innovation opportunities.

The loss from the Company's 50-percent equity joint venture (TIORCO) increased \$0.2 million year over year primarily due to lower commission and technical service income.

Other, net of \$1.6 million of income was essentially unchanged between years. Investment income (including realized and unrealized gains and losses) for the Company's deferred compensation and supplemental defined contribution mutual fund assets was up \$0.5 million. Foreign exchange losses increased \$0.5 million to \$0.7 million for the first three quarters of 2013 compared to \$0.2 million for the same period of 2012.

The effective tax rate was 27.6 percent for the first three quarters of 2013 compared to 32.1 percent for the same period of 2012. The decrease was attributable to a greater percentage of consolidated income being generated outside the U.S. where the effective tax rates are lower. The decrease also reflected the federal research and development tax credit and the small agri-biodiesel producer tax credit which were extended retroactively from January 1, 2012 through December 31, 2013 when *The American Taxpayer Relief Act of 2012* was signed into law on January 2, 2013. As a result of this legislation, the Company recorded a tax benefit of \$1.4 million in the first quarter of 2013 for amounts generated in 2012 and a tax benefit of \$1.2 million for amounts generated in 2013.

### Segment Results

| <i>(In thousands)</i>            | Surfactants | Polymers   | Specialty Products | Segment Results | Corporate | Total        |
|----------------------------------|-------------|------------|--------------------|-----------------|-----------|--------------|
| <u>For the nine months ended</u> |             |            |                    |                 |           |              |
| <u>September 30, 2013</u>        |             |            |                    |                 |           |              |
| Net sales                        | \$ 989,417  | \$ 354,972 | \$ 62,068          | \$ 1,406,457    |           | \$ 1,406,457 |
| Operating income                 | 79,712      | 43,364     | 8,340              | 131,416         | (36,168)  | 95,248       |
| <u>For the nine months ended</u> |             |            |                    |                 |           |              |
| <u>September 30, 2012</u>        |             |            |                    |                 |           |              |
| Net sales                        | \$ 995,346  | \$ 320,843 | \$ 60,289          | \$ 1,376,478    |           | \$ 1,376,478 |
| Operating income                 | 89,964      | 38,507     | 11,053             | 139,524         | (35,412)  | 104,112      |

#### Surfactants

Surfactants net sales for the first three quarters of 2013 declined \$5.9 million, or one percent, from net sales for the first three quarters of 2012. A six percent increase in sales volume favorably affected the year-over-year net sales change by \$55.8 million. All regions reported sales volume improvements. A decrease in average selling prices and the unfavorable effects of foreign currency translation had negative effects of \$60.3 million and \$1.4 million, respectively, on the net sales change. Reduced raw material costs led to the average selling price decline. A year-over-year comparison of net sales by region follows:

| <i>(In thousands)</i>            | For the Nine Months Ended |                    | Increase (Decrease) | Percent Change |
|----------------------------------|---------------------------|--------------------|---------------------|----------------|
|                                  | September 30, 2013        | September 30, 2012 |                     |                |
| North America                    | \$ 604,468                | \$ 625,864         | \$ (21,396)         | -3             |
| Europe                           | 216,062                   | 212,047            | 4,015               | +2             |
| Latin America                    | 121,888                   | 119,459            | 2,429               | +2             |
| Asia                             | 46,999                    | 37,976             | 9,023               | +24            |
| <b>Total Surfactants Segment</b> | <b>\$ 989,417</b>         | <b>\$ 995,346</b>  | <b>\$ (5,929)</b>   | <b>-1</b>      |



Net sales for North American operations declined three percent year over year. Sales volume increased by two percent primarily due to higher sales of functional surfactants used in agricultural applications and biodiesel and to increased consumer product sales. Lower sales volumes of oil field chemicals partially offset the gains for agricultural chemicals and biodiesel. Average selling prices declined five percent, which had a \$30.5 million negative effect on the year-over-year net sales change. Lower raw material costs and the effects of a customer contract selling price lag led to the decline in average selling prices. The increase in sales volume mitigated the impact of reduced selling prices by \$10.0 million. The effects of foreign currency translation had a \$0.9 million unfavorable effect on the net sales change.

Net sales for European operations increased two percent due to an eight percent increase in sales volume and to the favorable effects of foreign currency translation, which accounted for \$16.9 million and \$2.0 million, respectively, of the year-over-year growth in net sales. The sales volume increase reflected greater demand for Company products used in personal care, laundry and cleaning and agricultural chemical applications. The increased demand was principally from existing customers. Average selling prices declined six percent, which reduced the year-over-year net sales increase by \$14.9 million. Lower raw material costs led to the reduction in selling prices.

Net sales for Latin American operations increased two percent as a result of a nine percent increase in sales volume partially offset by a four percent decline in average selling prices and the negative effects of foreign currency translation. The higher sales volume had an \$11.2 million positive effect on the year-over-year net sales change, while the decline in selling prices and impact of foreign currency translation had negative effects of \$5.8 million and \$3.0 million, respectively. Sales volume for all three Latin American locations improved between years, with most of the increase derived from Brazil, as the Company continued to expand its surfactants franchise in that country. The decrease in average selling prices reflected declines in raw material costs.

Net sales for Asia operations increased 24 percent due to a 31 percent increase in sales volume. The sales volume increase reflected sales from the Singapore subsidiary, which was not commercially operational until the fourth quarter of 2012.

Surfactants operating income for the first three quarters of 2013 declined \$10.3 million, or 11 percent, from operating income for the same period of 2012. Gross profit fell \$6.8 million, or four percent, principally due to lower results from the segment's North American operations. The effects of foreign currency translation contributed \$0.6 million to the gross profit decline. Operating expenses increased \$3.5 million, or six percent. Year-over-year comparisons of gross profit by region and total segment operating expenses and operating income follow:

| <i>(In thousands)</i>     | For the Nine Months<br>Ended |                       | Increase<br>(Decrease) | Percent<br>Change |
|---------------------------|------------------------------|-----------------------|------------------------|-------------------|
|                           | September 30,<br>2013        | September 30,<br>2012 |                        |                   |
| <u>Gross Profit</u>       |                              |                       |                        |                   |
| North America             | \$ 102,299                   | \$ 116,707            | \$ (14,408)            | -12               |
| Europe                    | 18,581                       | 18,666                | (85)                   |                   |
| Latin America             | 17,215                       | 14,354                | 2,861                  | +20               |
| Asia                      | 6,932                        | 2,074                 | 4,858                  | +234              |
| Total Surfactants Segment | \$ 145,027                   | \$ 151,801            | \$ (6,774)             | -4                |
| Operating Expenses        | 65,315                       | 61,837                | 3,478                  | +6                |
| Operating Income          | \$ 79,712                    | \$ 89,964             | \$ (10,252)            | -11               |

North American gross profit declined 12 percent year over year primarily due to the consumption of high priced methyl ester inventories, which were built up in prior periods to support the Singapore start-up, increased competitive activity and customer contract selling price lags, which unfavorably impacted selling margins in 2013 while favorably impacting margins in 2012. Approximately \$2.2 million of reduced biodiesel gross profit was also a factor in the year-over-year decline in North American results.

Gross profit for European operations was essentially unchanged between years despite an eight percent increase in sales volume. A different mix of sales caused the decrease in gross profit, as most of the sales volume improvement came from the UK location where unit margins tend to be lower than product sold out of France.

Gross profit for Latin American operations increased 20 percent primarily due to the nine percent increase in sales volume. Average unit margins have also improved between years as a result of greater utilization of the Brazil site's new manufacturing capacity.

Asia operations gross profit improvement was principally the result of the Singapore subsidiary's contribution. The location was not commercially operational for the first three quarters of 2012.

Operating expenses for the surfactants segment were up \$3.5 million, or six percent, year over year. Selling, administrative and research and development expenses were up \$1.4 million, \$1.2 million and \$0.8 million, respectively. North American and Latin American operations accounted for \$1.0 million and \$0.4 million, respectively, of the selling expense increase. The accumulation of a number of small increases for Singapore methyl esters product registration costs, support costs for the TIORCO joint venture, travel expenses and bad debt provision contributed to the North American year-over-year change. In addition, 2012 included \$0.3 million of royalty income that was nonrecurring. Latin American's increase was attributable to rental expense for a sales office.

Asian and European operations contributed \$0.8 and \$0.4 million, respectively, to the increase in administrative expenses. The Asian increase reflected the accumulation of a number of items including salary, fringe benefit and software maintenance expenses. Higher salary and fringe benefit expenses accounted for most of the European increase.

The increase in research and development expenses comprised higher salary expense in North America and higher product registration expenses in Europe.



*Polymers*

Polymers net sales for the first three quarters of 2013 increased \$34.1 million, or 11 percent, over net sales for the first three quarters of 2012. Higher average selling prices, a five percent increase in sales volume and the favorable effects of foreign currency translation accounted for \$16.3 million, \$14.7 million and \$3.1 million, respectively, of the net sales improvement. The acquired BMS North American polyester resins business contributed \$18.2 million to 2013 net sales. A year-over-year comparison of net sales by region is displayed below:

| <i>(In thousands)</i>  | For the Nine Months<br>Ended |                       | Increase<br>(Decrease) | Percent<br>Change |
|------------------------|------------------------------|-----------------------|------------------------|-------------------|
|                        | September 30,<br>2013        | September 30,<br>2012 |                        |                   |
| North America          | \$ 218,689                   | \$ 200,515            | \$ 18,174              | +9                |
| Europe                 | 118,573                      | 101,899               | 16,674                 | +16               |
| Asia and Other         | 17,710                       | 18,429                | (719)                  | -4                |
| Total Polymers Segment | \$ 354,972                   | \$ 320,843            | \$ 34,129              | +11               |

Net sales for North American operations increased nine percent between years. The increase in net sales was largely attributable to the contribution of the BMS North American polyester resins acquisition made in June. The acquired business accounted for \$18.2 million of the year-over-year change in net sales. Net sales for the Company's pre-acquisition polymer business were unchanged between years on sales volume that declined four percent. Phthalic anhydride volume was down five percent due primarily to continued weak demand from polyester resin customers. Sales volume for rigid polyol products in insulation applications was down three percent largely as a result of a slow start to the construction season due to a protracted winter. Also affecting the year-over-year change in net sales was a significant 2012 sale of a urethane systems product used in a new aircraft carrier that did not recur in 2013. Average selling prices for the pre-acquisition business were up four percent year over year due to higher average raw material costs.

Net sales for European operations increased 16 percent due to a 12 percent improvement in sales volume, the effects of foreign currency translation and a one percent increase in average selling prices, which accounted for \$12.4 million, \$2.8 million and \$1.5 million, respectively, of the growth in net sales. Additional business at a number of major polyol customers accounted for the sales volume increase. The strengthening of the Polish zloty against the U.S. dollar led to the foreign currency translation effect.

Net sales for Asia and Other operations declined four percent between years due to a nine percent decrease in sales volume. The sales decline reflected uncertainty in the China economy as well as some lost business due to competitive activity.

Polymer operating income for the first three quarters of 2013 increased \$4.9 million, or 13 percent, over operating income for the first three quarters of 2012. Gross profit improved \$7.8 million due to improvement for North American and European operations. 2013 profits benefited from the receipt of a \$3.7 million insurance recovery related to lost business resulting from a 2011 fire that damaged polyol equipment at the Germany site. Operating expenses increased \$2.9 million, or 18 percent. Year-over-year comparisons of gross profit by region and total segment operating expenses and operating income follow:



| <i>(In thousands)</i>         | For the Nine Months<br>Ended |                       | Increase<br>(Decrease) | Percent<br>Change |
|-------------------------------|------------------------------|-----------------------|------------------------|-------------------|
|                               | September 30,<br>2013        | September 30,<br>2012 |                        |                   |
| <u>Gross Profit</u>           |                              |                       |                        |                   |
| North America                 | \$ 42,256                    | \$ 38,731             | \$ 3,525               | +9                |
| Europe                        | 20,807                       | 14,468                | 6,339                  | +44               |
| Asia and Other                | (12)                         | 2,056                 | (2,068)                | -101              |
| <b>Total Polymers Segment</b> | <b>\$ 63,051</b>             | <b>\$ 55,255</b>      | <b>\$ 7,796</b>        | <b>+14</b>        |
| Operating Expenses            | 19,687                       | 16,748                | 2,939                  | +18               |
| <b>Operating Income</b>       | <b>\$ 43,364</b>             | <b>\$ 38,507</b>      | <b>\$ 4,857</b>        | <b>+13</b>        |

Gross profit for North American operations increased nine percent between years mainly due to lower costs and to the contribution derived from the BMS business acquisition. The year-over-year reduction in costs reflected elevated prior year costs associated with the Company's triennial polymer plant maintenance shutdown. As a result of the shutdown, last year's profit was adversely affected by \$2.0 million of additional plant expenses and product outsourcing costs. In addition to the above, average unit margins improved between years due to a more favorable inventory position and to a more profitable mix of CASE and other specialty polyol sales. The year-over-year improvement in gross profit was tempered by a large third quarter 2012 sale of a urethane systems product used in a new aircraft carrier. There were no such sales in 2013.

The increase in gross profit for European operations was primarily driven by the previously mentioned \$3.7 million insurance recovery and the 12 percent improvement in sales volume. Increased unit margins and the favorable effects of foreign currency also contributed.

The decline in gross profit for Asia and Other operations was due to the nine percent decrease in sales volume, reduced selling margins and higher expenses. As a result of ceasing manufacturing at the Nanjing site, products are now being outsourced from other Company locations or outside processors, which leads to reduced selling margins. In addition, during 2013 the Company accelerated \$0.6 million of depreciation on all assets that were not projected to be moved to the new site.

Polymer operating expenses increased \$2.9 million, or 18 percent, year over year. The operating expense increase resulted, in large part, from higher research and development (\$0.9 million) and selling (\$0.8 million) expenses and to the unfavorable effects of foreign currency translation. Higher North American operation expenses for salaries, fringe benefits, outside service and travel expenses were the major contributors to the increased research and development expenses. Europe and North America accounted for \$0.5 million and \$0.3 million, respectively, of the rise in selling expenses. In addition to the increased research and selling expenses, 2013 expenses included a \$0.7 million charge for estimated dismantling costs for the manufacturing site in Nanjing, China.

*Specialty Products*

Net sales for the first three quarters of 2013 increased \$1.8 million, or three percent, over net sales for the same period of 2012. Operating income declined \$2.7 million due to higher raw material costs, competitive pricing pressures and increased manufacturing and operating expenses, especially for the Company's medium-chain triglyceride products used in food ingredient applications.

*Corporate Expenses*

Corporate expenses increased \$0.8 million to \$36.2 million for the first three quarters of 2013 from \$35.4 million for the first three quarters of 2012. In large part, the increase in corporate expenses reflected the Company's continued investment in its growth and innovation initiatives. Increases in legal, salary and expatriate expenses accounted for \$1.4 million, \$0.8 million and \$0.4 million, respectively of the year-over-year change in corporate expenses. In addition, statutory profit sharing expense in France was up \$1.1 million, and corporate computer hardware and software expenses were up \$0.4 million.

A \$2.8 million decline in deferred compensation expense partially offset the foregoing increases. The value of Company common stock increased less in 2013 than in 2012, which drove the reduction in deferred compensation expense. The value of Company stock increased \$2.19 per share for the first three quarters of 2013 compared to \$7.98 per share for the same period of 2012. The following table presents the quarter-end Company common stock prices used in the computation of deferred compensation expense:

|                     | 2013         |             | 2012         |             | 2011         |             |
|---------------------|--------------|-------------|--------------|-------------|--------------|-------------|
|                     | September 30 | December 31 | September 30 | December 31 | September 30 | December 31 |
| Company Stock Price | \$ 57.73     | \$ 55.54    | \$ 48.06     | \$ 40.08    |              |             |

**LIQUIDITY AND CAPITAL RESOURCES**

For the nine months ended September 30, 2013, operating activities were a source of \$81.7 million versus \$78.0 million for the comparable period in 2012. For the current year period, investing cash outflows totaled \$139.9 million and non-debt financing activities consumed \$7.5 million. To fund these cash requirements, the Company increased debt by \$93.8 million. Cash was increased by \$26.2 million with exchange rates reducing cash by \$1.9 million.

For the current year-to-date, net income was down by \$2.4 million and working capital consumed \$2.9 million more than for the comparable year-ago period. Cash outflows for investing activities were up by \$76.7 million year over year. Cash provided by financing activities was a source of \$86.3 million in 2013 compared to a use of \$19.9 million in 2012.

For the current year-to-date, accounts receivable were a use of \$41.1 million compared to a use of \$5.5 million use for the comparable period in 2012. Inventories were a use of \$9.6 million in 2013 versus a use of \$44.1 million in 2012. Accounts payable and accrued liabilities were a source of \$26.6 million in 2013 compared to a source of \$24.7 million for the same period in 2012.

During the first nine months of both 2013 and 2012, changes in raw material costs had relatively little effect on working capital. The Company's working capital investment is heavily influenced by the cost of crude oil and natural oils, from which many of its raw materials are derived. Fluctuations in raw material costs translate directly to inventory carrying costs and indirectly to customer selling prices and accounts receivable.

The higher current year accounts receivable cash use continued to be driven by current quarter 2013 net sales exceeding fourth quarter 2012 net sales more than for the comparable quarters last year. Accounts receivable turnover did not change significantly between December 31, 2012, and September 30, 2013 and turnover was not a significant factor in the year-over-year cash flow comparisons. The year-to-date inventory cash use was driven mainly by higher quantities to support customer service levels for the U.S. The Company has not changed its own payments practices related to its payables. It is management's opinion that the Company's liquidity is sufficient to provide for potential increases in working capital during the remainder of 2013.

Investing cash outflows for the current year-to-date included capital expenditures of \$67.1 million compared to \$60.9 million for the comparable period last year. Current period investing outflows also included \$68.2 million for the acquisition of the North American polyester resins business of BMS, discussed previously. Other investing activities consumed \$4.6 million in 2013 versus \$2.3 million in 2012.

For 2013, the Company estimates that capital expenditures will range from \$90 million to \$100 million including capacity expansions in Brazil, Germany, Singapore and the United States.

The Company purchases its common shares in the open market from time to time to fund its own benefit plans and also to mitigate the dilutive effect of new shares issued under its benefit plans. The Company may also make open market repurchases as cash flows permit when, in management's opinion, the Company's shares are undervalued in the market. For the first nine months of 2013, the Company purchased 41,688 shares in the open market at a total cost of \$2.3 million. At September 30, 2013, there were 958,312 shares remaining under the current share repurchase authorization. Also, as announced on June 12, 2013, the Company redeemed all shares of its 5 1/2 percent convertible preferred stock without par value (preferred stock) outstanding at August 9, 2013. Preferred stockholders tendered 835 shares of Company preferred stock for a redemption price of \$25.00 per share plus accrued and unpaid dividends of \$0.26354 per share. There are no longer any issued and outstanding shares of preferred stock.

As of September 30, 2013, the Company's cash and cash equivalents totaled \$103.1 million, including \$34.8 million in two separate U.S. money market funds, each of which was rated AAA by Standard and Poor's and Aaa by Moody's. Cash in U.S. demand deposit accounts totaled \$16.2 million and cash of the Company's non-U.S. subsidiaries held outside the U.S. totaled \$52.1 million at September 30, 2013.

Consolidated balance sheet debt increased by \$94.4 million for the current year to date, from \$182.4 million to \$276.8 million. Since last year end, domestic debt increased by \$95.7 million and foreign debt decreased by \$1.3 million. Net debt (which is defined as total debt minus cash) increased by \$68.2 million for the current year to date, from \$105.5 million to \$173.7 million. As of September 30, 2013, the ratio of total debt to total debt plus shareholders' equity was 34.2 percent compared to 27.5 percent at December 31, 2012. As of September 30, 2013, the ratio of net debt to net debt plus shareholders' equity was 24.6 percent compared to 18.0 percent at December 31, 2012.



At September 30, 2013, the Company's debt included \$247.9 million of unsecured private placement loans with maturities extending from 2013 through 2025. These loans are the Company's primary source of long-term debt financing and are supplemented by bank credit facilities to meet short and medium-term needs.

On June 27, 2013, the Company entered into a \$100.0 million long-term private placement loan with five insurance companies. This loan bears interest at a fixed rate of 3.86% with interest to be paid semi-annually and with equal annual principal payments beginning on June 27, 2019, and continuing through final maturity on June 27, 2025. Stepan used the net proceeds from the issuance of the notes primarily to finance the Company's acquisition of the North American Polyester Resins business of BMS, including the production facility located in Columbus, Georgia, and expects to use the remaining proceeds for related capital expenditures and working capital as well as for general corporate purposes. This loan agreement requires the maintenance of certain financial ratios and covenants that are substantially identical to the Company's existing long-term debt and customary events of default.

The Company has a committed \$125.0 million multi-currency syndicated revolving credit agreement. The credit agreement allows the Company to make unsecured borrowings, as requested from time to time, for working capital and other corporate purposes. This unsecured facility is the Company's primary source of short-term borrowings and is committed through September 20, 2017, with terms and conditions that are substantially equivalent to those of the Company's other U.S. loan agreements. As of September 30, 2013, the Company had outstanding letters of credit of \$2.8 million and no borrowings under this agreement, with \$122.2 million remaining available. The Company anticipates that cash from operations, committed credit facilities and cash on hand will be sufficient to fund anticipated capital expenditures, working capital, dividends and other planned financial commitments for the foreseeable future.

Certain foreign subsidiaries of the Company maintain term loans and short-term bank lines of credit in their respective local currencies to meet working capital requirements as well as to fund capital expenditure programs and acquisitions. At September 30, 2013, the Company's European subsidiaries had bank term loans of \$6.4 million with maturities through 2016 and short-term bank debt of \$20.8 million with remaining short-term borrowing capacity of \$15.1 million. The Company's Latin American subsidiaries had no short-term bank debt with \$9.9 million of unused short-term borrowing capacity. The Company's Philippine subsidiary had \$1.7 million of short-term bank loans, which were guaranteed by the Company, with \$6.3 million of unused borrowing capacity. The Company's majority-owned joint venture in China had no short-term bank debt, with unused borrowing capacity of \$6.5 million, on bank credit lines guaranteed by the Company.

The Company has material debt agreements that require the maintenance of minimum interest coverage and minimum net worth. These agreements also limit the incurrence of additional debt as well as the payment of dividends and repurchase of treasury shares. Testing for these agreements is based on the combined financial statements of the U.S. operations of the Company, Stepan Canada Inc., Stepan Specialty Products, LLC, Stepan Specialty Products B.V. and Stepan Asia Pte. Ltd. (the Restricted Group). Under the most restrictive of these debt covenants:

1. The Restricted Group must maintain a minimum interest coverage ratio, as defined within the agreements, of 2.0 to 1.0, for the preceding four calendar quarters.

2. The Restricted Group must maintain net worth of at least \$275.0 million.
3. The Restricted Group must maintain a ratio of long-term debt to total capitalization, as defined in the agreements, not to exceed 55 percent.
4. The Restricted Group may pay dividends and purchase treasury shares after December 31, 2011, in amounts of up to \$100.0 million plus 100 percent of net income and cash proceeds of stock option exercises, measured cumulatively after June 30, 2012. The maximum amount of dividends that could have been paid within this limitation is disclosed as unrestricted retained earnings in Note 13, Debt, in the Notes to Consolidated Financial Statements.

The Company believes it was in compliance with all of its loan agreements as of September 30, 2013. Based on current projections, the Company believes it will be in compliance with its loan agreements throughout 2013.

#### ENVIRONMENTAL AND LEGAL MATTERS

The Company is subject to extensive federal, state and local environmental laws and regulations. Although the Company's environmental policies and practices are designed to ensure compliance with these laws and regulations, future developments and increasingly stringent environmental regulation could require the Company to make additional unforeseen environmental expenditures. The Company will continue to invest in the equipment and facilities necessary to comply with existing and future regulations. During the first nine months of 2013 and 2012, the Company's expenditures for capital projects related to the environment were \$3.4 million and \$2.8 million, respectively. These projects are capitalized and depreciated over their estimated useful lives, which are typically 10 years. Recurring costs associated with the operation and maintenance of facilities for waste treatment and disposal and managing environmental compliance in ongoing operations at the Company's manufacturing locations were \$13.8 million and \$13.7 million for the nine months ended September 30, 2013 and 2012, respectively. While difficult to project, it is not anticipated that these recurring expenses will increase significantly in the future.

Over the years, the Company has received requests for information related to or has been named by the government as a potentially responsible party at a number of waste disposal sites where cleanup costs have been or may be incurred under CERCLA and similar state statutes. In addition, damages are being claimed against the Company in general liability actions for alleged personal injury or property damage in the case of some disposal and plant sites. The Company believes that it has made adequate provisions for the costs it may incur with respect to the sites. It is the Company's accounting policy to record liabilities when environmental assessments and/or remedial efforts are probable and the cost or range of possible costs can be reasonably estimated. When no amount within the range is a better estimate than any other amount, the minimum is accrued. Some of the factors on which the Company bases its estimates include information provided by feasibility studies, potentially responsible party negotiations and the development of remedial action plans. After partial remediation payments at certain sites, the Company has estimated a range of possible environmental and legal losses of \$9.8 million to \$29.0 million at September 30, 2013, compared to \$10.3 million to \$28.9 million at December 31, 2012. At September 30, 2013, and December 31, 2012, the Company's accrued liability for such losses, which represented the Company's best estimate within the estimated range of possible environmental and legal losses, was \$14.8 million and \$15.4 million, respectively. During the nine months of 2013, cash outlays related to legal and environmental matters approximated \$1.8 million compared to \$2.2 million for the same period in 2012.

For certain sites, the Company has responded to information requests made by federal, state or local government agencies but has received no response confirming or denying the Company's stated positions. As such, estimates of the total costs, or range of possible costs, of remediation, if any, or the Company's share of such costs, if any, cannot be determined with respect to these sites. Consequently, the Company is unable to predict the effect thereof on the Company's financial position, cash flows and results of operations. Given the information available, management believes the Company has no liability at these sites. However, in the event of one or more adverse determinations with respect to such sites in any annual or interim period, the effect on the Company's cash flows and results of operations for those periods could be material. Based upon the Company's present knowledge with respect to its involvement at these sites, the possibility of other viable entities' responsibilities for cleanup, and the extended period over which any costs would be incurred, the Company believes that these matters, individually and in the aggregate, will not have a material effect on the Company's financial position. Certain of these matters are discussed in Item 1, Part 2, Legal Proceedings, in this report and in other filings of the Company with the Securities and Exchange Commission, which are available upon request from the Company. See also Note 8 to the condensed consolidated financial statements for a summary of the environmental proceedings related to certain environmental sites.

## OUTLOOK

The Company delivered slightly improved results in the third quarter, and management remains optimistic about the Company's long-term growth. The slow start to the year has made achieving full year earnings growth difficult, but the Company continues to pursue investments that should accelerate its growth. In 2014 the Company should realize the benefits of its recent acquisition and other capacity expansions. The Company's balance sheet continues to be healthy, and dividends were increased for the forty-sixth consecutive year reflecting the Company's continued commitment to generating shareholder value.

Global surfactant consumer product volumes should continue to grow, particularly in Brazil. The higher raw material cost inventory built to support the Singapore plant start-up and the subsequent decline in commodity prices negatively impacted year-to-date surfactant profit by \$4.0 million. The positive side of this is that the Singapore methyl ester plant is operating well and is contributing to Company profitability, and the remaining negative impact of this inventory will not carry beyond 2013. Surfactants sold for use in enhanced oil recovery are expected to improve compared to the slow year-to-date results. Demand for agricultural surfactants should remain strong.

The polymer segment delivered strong quarterly results despite the continuing global economic uncertainty and the negative year-over-year impact of the Company's China operations. The second quarter acquisition of the North America polyester resin business from BMS should be slightly accretive to earnings in 2013 and more so as capacity is increased to manufacture additional polyol products for CASE applications. Early fourth quarter polyol orders are strong in both North America and Europe, as it appears that the Company is getting some business not shipped earlier in the year due to poor weather.

CRITICAL ACCOUNTING POLICIES

There have been no changes to the critical accounting policies disclosed in the Company's 2012 Annual Report on Form 10-K.

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

There have been no material changes to the market risks disclosed in the Company's 2012 Annual Report on Form 10-K.

**Item 4 Controls and Procedures**

a. Evaluation of Disclosure Controls and Procedures

Based on their evaluation of our disclosure controls and procedures as of the end of the most recent fiscal quarter covered by this Form 10-Q, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934) were effective as of September 30, 2013.

b. Changes in Internal Control Over Financial Reporting

There were no changes in internal controls that occurred during our most recent fiscal quarter 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 1 Legal Proceedings**

***Maywood, New Jersey Site***

The Company's property in Maywood, New Jersey and property formerly owned by the Company adjacent to its current site and other nearby properties (Maywood site) were listed on the National Priorities List in September 1993 pursuant to the provisions of CERCLA because of certain alleged chemical contamination. Pursuant to an Administrative Order on Consent entered into between USEPA and the Company for property formerly owned by the Company, and the issuance of an order by USEPA to the Company for property currently owned by the Company, the Company has completed various Remedial Investigation Feasibility Studies (RI/FS) and has recorded a liability based on its best estimate of the remediation costs.

On August 23, 2013, USEPA issued a Feasibility Study and a Proposed Plan selecting remedies for soil remediation which, in some cases, may be different from those the Company used in determining its best estimate. The Proposed Plan is subject to an ongoing comment period. The Company continues to review the Proposed Plan and Feasibility Study in anticipation of responding to USEPA. Until such time as USEPA completes its remedy selection process, the Company does not know the scope of remediation that may be required. At this time, based on its current review and analysis of the Proposed Plan, the Company's recorded liability for claims associated with remediation of chemical contamination at the Maywood site represents its best estimate of the cost of remediation for the Maywood site. The estimated cost of such remediation could differ from the Company's current recorded liability, for example, if the Proposed Plan is adopted without any changes or based on the availability of additional information.

In addition, under the terms of a settlement agreement reached on November 12, 2004, the United States Department of Justice and the Company agreed to fulfill the terms of a Cooperative Agreement reached in 1985 under which the United States will take title to and responsibility for radioactive waste removal at the Maywood site, including past and future remediation costs incurred by the United States. As such, the Company recorded no liability related to this settlement agreement.

**Item 1A Risk Factors**

There have been no material changes from the risk factors disclosed in the Company's 2012 Annual Report on Form 10-K.

**Item 2 Unregistered Sales of Equity Securities and Use of Proceeds**

| <b>Period</b> | <b>Total<br/>Number<br/>of<br/>Shares<br/>Purchased</b> | <b>Average<br/>Price<br/>Paid<br/>per<br/>Share</b> | <b>Total<br/>Number<br/>of<br/>Shares<br/>Purchased<br/>as Part<br/>of<br/>Publicly<br/>Announced<br/>Plans<br/>or<br/>Programs</b> | <b>Maximum<br/>Number<br/>of<br/>Shares<br/>that<br/>May<br/>Yet Be<br/>Purchased<br/>Under<br/>the<br/>Plans<br/>or<br/>Programs</b> |
|---------------|---|---|---|---|
| July          |   |   |   |   |
| August        | 835(a)  | \$ 25   |   |   |
| September     |   |   |   |   |

- (a) As announced on June 12, 2013, the Company redeemed all shares of its 5 ½ percent Convertible Preferred Stock without par value (preferred stock) outstanding at August 9, 2013. Preferred stockholders tendered 835 shares of Company preferred stock for a redemption price of \$25.00 per share plus accrued and unpaid dividends of \$0.26354 per share. There are no longer any issued and outstanding shares of preferred stock.

**Item 3 Defaults Upon Senior Securities**

None

**Item 4 Mine Safety Disclosures**

Not applicable

**Item 5 Other Information**

None

**Item 6 Exhibits**

- (a) Exhibit 3(a) Copy of Restated Certificate of Incorporation of Stepan Company, filed October 21, 2013, with the State of Delaware
- (b) Exhibit 10(a) Copy of Form of Stock Awards Agreement under Stepan Company 2011 Incentive Compensation Plan
- (c) Exhibit 31.1 Certification of President and Chief Executive Officer pursuant to Exchange Act Rule 13a-14(a)/15d-14(a)
- (d) Exhibit 31.2 Certification of Vice President and Chief Financial Officer pursuant to Exchange Act Rule 13a-14(a)/15d-14(a)
- (e) Exhibit 32 Certification pursuant to 18 U.S.C. Section 1350
- (f) Exhibit 101.INS XBRL Instance Document
- (g) Exhibit 101.SCH XBRL Taxonomy Extension Schema Document
- (h) Exhibit 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
- (i) Exhibit 101.DEF XBRL Taxonomy Extension Definition Document
- (j) Exhibit 101.LAB XBRL Taxonomy Extension Label Linkbase Document
- (k) Exhibit 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document



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.

STEPAN COMPANY

Date: October 30, 2013

/s/ Scott D. Beamer  
Scott D. Beamer  
Vice President and Chief Financial Officer