STEPAN CO
Form 10-Q
October 30, 2008

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(MARK ONE)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2008

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
FOR THE TRANSITION PERIOD FROM _____ TO _____

1-4462

Commission File Number

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 x 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 x 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 x

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 30, 2008**
Common Stock, $1 par value	9,621,041 Shares

Part I **FINANCIAL INFORMATION**

Item 1 Financial Statements

STEPAN COMPANY

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

Unaudited

	Three Months Ended September 30		Nine Months Ended September 30	
(In thousands, except per share amounts)	**2008**	**2007**	**2008**	**2007**
Net Sales	$ 432,947	$ 338,398	$ 1,234,797	$ 987,558
Cost of Sales	390,162	303,530	1,096,153	879,607
Gross Profit	42,785	34,868	138,644	107,951
Operating Expenses:				
Marketing	11,290	8,899	31,470	26,940
Administrative	11,776	9,748	35,716	28,979
Research, development and technical services	9,293	7,983	26,567	23,566
	32,359	26,630	93,753	79,485
Sale of land (Note 5)	(8,469)		(8,469)	
Sale of product line (Note 4)	(9,929)	35	(9,929)	(4,255)
Goodwill impairment charge (Note 13)				3,467
Operating Income	28,824	8,203	63,289	29,254
Other Income (Expenses):				
Interest, net	(2,447)	(2,395)	(7,367)	(7,218)
Loss from equity in joint venture	(1,368)	(66)	(2,245)	(202)
Other, net (Note 16)	(599)	(1,187)	(1,960)	(1,740)
	(4,414)	(3,648)	(11,572)	(9,160)
Income Before Provision for Income Taxes and Minority Interest	24,410	4,555	51,717	20,094
Provision for Income Taxes	7,379	1,457	16,205	6,656
Minority Interest	31	12	4	(72)
Net Income	$ 17,000	$ 3,086	$ 35,508	$ 13,510
Net Income Per Common Share (Note 11):				
Basic	$ 1.75	$ 0.31	$ 3.67	$ 1.39
Diluted	$ 1.59	$ 0.31	$ 3.39	$ 1.34
Shares Used to Compute Net Income Per Common Share (Note 11):				
Basic	9,628	9,325	9,521	9,306
Diluted	10,694	10,119	10,468	10,092

Dividends per Common Share	$ 0.2100	$ 0.2050	$ 0.6300	$ 0.6150

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

STEPAN COMPANY

CONDENSED CONSOLIDATED BALANCE SHEETS

Unaudited

(Dollars in thousands)	**September 30, 2008**	**December 31, 2007**
Assets		
Current Assets:		
Cash and cash equivalents	$ 5,598	$ 5,739
Restricted cash (Note 5)	8,634	
Receivables, net	237,461	184,277
Inventories (Note 8)	105,813	86,344
Deferred income taxes	9,658	8,855
Other current assets	9,583	8,717
Total current assets	376,747	293,932
Property, Plant and Equipment:		
Cost	919,895	908,843
Less: accumulated depreciation	683,212	674,781
Property, plant and equipment, net	236,683	234,062
Goodwill, net	4,494	4,543
Other intangible assets, net	5,836	6,687
Long-term investments (Note 3)	12,973	14,803
Other non-current assets	17,845	19,158
Total assets	$ 654,578	$ 573,185
Liabilities and Stockholders Equity		
Current Liabilities:		
Current maturities of long-term debt (Note 15)	$ 28,395	$ 31,024
Accounts payable	139,744	125,071
Accrued liabilities	51,313	44,883
Total current liabilities	219,452	200,978
Deferred income taxes	5,957	3,680
Long-term debt, less current maturities (Note 15)	121,221	96,939
Other non-current liabilities	66,364	64,861
Commitments and Contingencies (Note 9)		
Minority Interest	998	676
Stockholders Equity:		
5- $^{1}/2$% convertible preferred stock, cumulative, voting without par value; authorized 2,000,000 shares; issued and outstanding 555,732 shares in 2008 and 567,754 shares in 2007	13,893	14,194

Common stock, $1 par value; authorized 30,000,000 shares; Issued 10,829,898 shares in 2008 and 10,457,185 shares in 2007		10,830		10,457
Additional paid-in capital		54,497		37,618
Accumulated other comprehensive income (loss)		(8,634)		245
Retained earnings (unrestricted approximately $62,290 in 2008 and $38,187 in 2007) (Note 2)		198,126		168,338
Less: Treasury stock, at cost 1,208,857 shares in 2008 and 1,148,031 shares in 2007		(28,126)		(24,801)
Stockholders equity		240,586		206,051
Total liabilities and stockholders equity	$	654,578	$	573,185

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

(Dollars in thousands)	**Nine Months Ended September 30 2008**	**2007**
Cash Flows From Operating Activities		
Net income	$ 35,508	$ 13,510
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	28,039	27,960
Deferred compensation	4,385	1,519
Unrealized loss on long-term investments	2,740	
Stock-based compensation	3,856	757
Deferred income taxes	4,683	1,298
Goodwill impairment charge		3,467
Gain on sale of product line	(9,929)	(4,255)
Sale of land	(8,469)	
Other non-cash items	2,210	(934)
Changes in assets and liabilities:		
Receivables, net	(62,308)	(16,248)
Inventories	(22,218)	(8,846)
Other current assets	(945)	(224)
Accounts payable and accrued liabilities	30,143	14,171
Pension liabilities	141	(3,394)
Environmental and legal liabilities	(571)	(5,214)
Deferred revenues	(1,145)	(101)
Excess tax benefit from stock options	(2,843)	(290)
Net Cash Provided By Operating Activities	3,277	23,176
Cash Flows From Investing Activities		
Expenditures for property, plant and equipment	(35,591)	(29,326)
Proceeds from sale of product line	9,929	6,200
Increase in restricted cash	(8,634)	
Proceeds from sale of land	8,634	
Other	(1,570)	(345)
Net Cash Used In Investing Activities	(27,232)	(23,471)
Cash Flows From Financing Activities		
Revolving debt and notes payable to banks, net	483	13,620
Term loan	30,000	
Other debt borrowings	2,906	264
Other debt repayments	(11,047)	(7,753)
Dividends paid	(6,554)	(6,282)
Stock option exercises	6,708	1,026
Excess tax benefit from stock options	2,843	290
Other, net	(1,198)	(96)
Net Cash Provided By Financing Activities	24,141	1,069
Effect of Exchange Rate Changes on Cash	(327)	374
Net Increase (Decrease) in Cash and Cash Equivalents	(141)	1,148

Cash and Cash Equivalents at Beginning of Period		5,739		5,369
Cash and Cash Equivalents at End of Period	$	5,598	$	6,517
Supplemental Cash Flow Information				
Cash payments of income taxes, net of refunds	$	6,632	$	7,704
Cash payments of interest	$	7,105	$	6,896

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

STEPAN COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2008

Unaudited

1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The condensed consolidated financial statements included herein have been prepared by Stepan Company (the 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 normal recurring adjustments necessary to present fairly the Company s financial position as of September 30, 2008, its results of operations for the three and nine months ended September 30, 2008 and 2007 and its cash flows for the nine months ended September 30, 2008 and 2007, 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 2007 Form 10-K.

2. FAIR VALUE OPTION

In January 2008, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities.* SFAS No. 159 expands the scope of what entities may carry at fair value by offering an irrevocable option to record many types of financial assets and liabilities at fair value. Period-to-period changes in fair value are recorded in an entity s income statement.

On January 1, 2008, the Company elected the fair value option for the mutual fund investment assets related to its deferred compensation plans. The fair value election for the mutual fund investment assets was made to reduce the income volatility caused by the prior accounting treatment for the Company s deferred compensation plans. In accordance with SFAS No. 159, the mutual fund investment assets, which were previously classified as available-for-sale securities, are treated as trading securities. Therefore, beginning in 2008, fair value changes for the mutual fund investment assets are recorded in the income statement in the same periods that the offsetting changes in the deferred compensation liabilities are recorded. In prior years, value changes for the mutual fund investments were recorded as direct adjustments to shareholders equity in accumulated other comprehensive income.

In compliance with the transition rules of SFAS No. 159, $834,000 of cumulative unrealized mutual fund investment gains (net of taxes of $540,000), which were included in accumulated other comprehensive income on December 31, 2007, were reclassified into retained earnings in January 2008. The Company recognized $1,560,000 of unrealized losses on trading securities for the three months ended September 30, 2008, and $2,740,000 of unrealized losses for the nine months ended September 30, 2008. The gains and losses were recorded in the Other, net line of the consolidated statements of income. See Note 16.

3. FAIR VALUE MEASUREMENTS

In January 2008, the Company adopted SFAS No. 157, *Fair Value Measurements*. The guidance in the new standard is applicable in circumstances where other accounting pronouncements mandate or permit fair value measurements. In February 2008, the Financial Accounting Standards Board (FASB) issued FASB Staff Position Nos. FAS 157-1 and FAS 157-2 (FSP FAS 157-1 and 157-2). FSP FAS 157-1 excludes SFAS No. 13, *Accounting for Leases*, as well as other accounting pronouncements that address fair value measurements for leases, from the scope of SFAS No. 157. FSP FAS 157-2 delays the effective date of SFAS No. 157 for all nonrecurring fair value measurements of nonfinancial assets and liabilities until fiscal years beginning after November 15, 2008.

SFAS No. 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The standard establishes a framework, in the form of a three-level hierarchy, for measuring fair value. The fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value. It gives the highest priority, Level 1, to inputs that are quoted prices in active markets for identical assets and liabilities. Level 2 represents inputs other than quoted prices included within Level 1 that are directly or indirectly observable and market-based information for similar assets and liabilities. Level 3 includes unobservable inputs which reflect the entity s own assumptions about the assumptions market participants use in pricing the assets and liabilities.

The following table presents assets and liabilities measured at fair value as of September 30, 2008 and the level within the fair value hierarchy in which the fair value measurements fall:

(Dollars in thousands)	**September 2008**	**Level 1**	**Level 2**	**Level 3**
Mutual fund assets	$ 12,973	$ 12,973	$	$
Derivative assets	592		592	
Total assets at fair value	$ 13,565	$ 12,973	$ 592	$
Derivative liabilities	$ 309	$	$ 309	$
Total liabilities at fair value	$ 309	$	$ 309	$

4. SALE OF PRODUCT LINE

On July 31, 2008, the Company sold select polyurethane system product lines to Bayer MaterialScience LLC (Bayer). No manufacturing assets were included in the sale. The sold product lines were insulation materials used in appliances, water heaters, doors, roofs, picnic coolers and other similar applications, and represented approximately

$16,000,000 in Company annual net sales. The products, which are manufactured at the Company s Millsdale, Illinois, facility, will continue to be produced for Bayer during a transition period of up to two years. The sale was for $9,929,000 of cash, and the entire receipt of cash was recorded as a gain in the third quarter ended September 30, 2008. The gain was attributed to the polymer segment.

On April 30, 2007, the Company sold its specialty ester surfactant product line for the personal care market to The HallStar Company (formerly CPH Holding Corporation). No physical assets were included in the sale. The product line represented approximately $15,000,000 in Company net sales. The sale was for $6,200,000 of cash plus the transfer to the Company of a specialty agricultural surfactant product line, which included $250,000 of intangible assets and $196,000 of inventory. As a result of the sale, the Company reported a $4,290,000 pretax gain in the second quarter ended June 30, 2007. The adjusted gain at September 30, 2007, was $4,255,000. The entire gain was attributed to the surfactants segment.

5. LAND SALE AND OFFICE BUILDING PURCHASE

In September 2008, the Company sold 88 acres of land at its Millsdale manufacturing facility in Elwood, Illinois, to an industrial park developer for $8,634,000. The land had a cost basis of $165,000, so the Company recorded a pretax gain of $8,469,000. The gain was not attributed to any reportable segment. Also in September 2008, the Company purchased a 64,000 square foot office building along with 3.25 acres of land near its corporate headquarters for $6,442,000. The office building will house employees currently located in a leased facility nearing the end of its lease term. For income tax purposes, the Millsdale land sale and the office building purchase were structured as a tax-deferred, like-kind exchange pursuant to section 1031 of the U.S. Internal Revenue Code (IRC). To accomplish the tax-deferred exchange, the Company directed that the land sale proceeds be deposited with and held by a qualified intermediary until consummation of the exchange, which occurs when renovations to the office building are completed. As a result, the proceeds from the land sale are considered restricted cash for financial statement reporting purposes.

6. INVESTMENT IN CHINA JOINT VENTURE

On May 15, 2008, the Company increased its controlling ownership stake in the Stepan China joint venture (a reporting unit within the Company s polymer reportable segment) from 55 percent to 80 percent. The Company achieved the step up in ownership by contributing an additional $3,109,000 of capital (all cash) to Stepan China. By agreement, the minority joint venture partner made no additional capital contribution, thereby reducing its minority ownership stake in Stepan China from 45 percent to 20 percent. The Company accounted for this transaction as a step acquisition, applying purchase accounting treatment as required by SFAS No. 141, *Business Combinations*. No intangible assets or goodwill were acquired as a result of the step acquisition. Stepan China s accounts have been included in the Company s consolidated financial statements since the formation of the joint venture, when the Company first obtained controlling interest.

7. STOCK-BASED COMPENSATION

The Company has stock options outstanding under its 1992 Stock Option Plan and stock options and stock awards outstanding under its 2000 Stock Option Plan and its 2006 Incentive Compensation Plan. Compensation expense charged against income for all plans was $1,202,000 and $3,856,000, respectively, for the three and nine months ended September 30, 2008, compared to $274,000 and $757,000, respectively, for the three and nine months ended September 30, 2007. Unrecognized compensation cost for stock options and stock awards was $801,000 and $3,158,000, respectively, at September 30, 2008, compared to $504,000 and $574,000, respectively, at December 31, 2007. The increases in compensation expense and the increases in unrecognized compensation costs since December 31, 2007, resulted primarily from management s assessment that the probable levels of profitability on which the vesting of performance stock awards are based would be higher than originally projected, which led to an increase in the number of performance stock awards that are ultimately expected to vest. Also, contributing to the increases in compensation expense and unrecognized compensation costs were 2008 grants of 124,195 stock options and 94,500 performance stock awards. No options or performance stock awards were granted in the third quarter of 2008. The unrecognized compensation cost at September 30, 2008, is expected to be recognized over weighted average periods of 1.2 years and 1.8 years for stock options and performance stock awards, respectively.

8. INVENTORIES

Inventories comprise the following:

(Dollars in thousands)	**September 30, 2008**	**December 31, 2007**
Finished products	$ 69,609	$ 59,732
Raw materials	36,204	26,612
Total inventories	$ 105,813	$ 86,344

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 $44,436,000 and $30,961,000 higher than reported at September 30, 2008, and December 31, 2007, respectively.

9. 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 PRP at 23 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.

The Company has estimated a range of possible environmental and legal losses from $10.8 million to $34.4 million at September 30, 2008. At September 30, 2008, the Company s accrued liability for such losses, which represents the Company s best estimate within the estimated range of possible environmental and legal losses, was $16.7 million compared to $17.2 million at December 31, 2007. During the first nine months of 2008, non-capital cash outlays related to legal and environmental matters approximated $2.0 million compared to $6.8 million in the first nine months of 2007. In 2007, the Company paid a personal injury settlement related to the Company s formerly owned site in Wilmington, Massachusetts.

For certain sites, estimates cannot be made of the total costs of compliance, or the Company s share of such costs; consequently, the Company is unable to predict the effect thereof on the Company s financial position, cash flows and results of operations. Management believes that in the event of one or more adverse determinations in any annual or interim period, the impact on the Company s cash flows and results of operations for those periods could be material. However, based upon the Company s present belief as to its relative involvement at these sites, 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, 2008:

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 completed a Remedial Investigation Feasibility Study (RI/FS) in 1994. The Company submitted the Draft Final FS for Soil and Source Areas (Operable Unit 1) in September 2002. In addition, the Company submitted the Draft Final FS for Groundwater (Operable Unit 2) in June 2003 and also submitted additional information regarding groundwater in May

2007 and June 2008. The Company expects to file an updated FS with the USEPA in late 2008 or early 2009. The final Record of Decision will be issued sometime after a public comment period.

Also, the New Jersey Department of Environmental Protection (NJDEP) filed a complaint against the Company and other entities on February 6, 2006, alleging that the defendants discharged hazardous substances at the Maywood site and at neighboring properties not part of the Maywood site resulting in damage to natural resources and the incurrence of response costs. The Company has reached a settlement agreement in principal to resolve said litigation. Such agreement in principal is subject to additional approvals, including final execution of a settlement agreement. The Company believes that a resolution of its liability for this litigation will not have a material impact on the financial position, results of operations or cash flows of the Company.

The Company believes it has adequate reserves for claims associated with the Maywood site, and has recorded a liability for the estimated probable costs it expects to incur at the Maywood site related to remediation of chemical contamination. However, depending on the results of the ongoing discussions with USEPA, the final cost of such remediation could differ from the current estimates.

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.

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 the second quarter of 2007, the Company reached an agreement with respect to the past costs and future allocation percentage in said litigation for costs related to the D Imperio site, including costs to comply with USEPA s Unilateral Administrative Orders. The Company paid the settlement amount in the third quarter of 2007**.** The resolution of the Company s liability for this litigation did not have a material impact on the financial position, results of operations or cash flows of the Company. In December 2007, the Company received updated remediation cost estimates, which were considered in the Company s determination of its range of estimated possible losses and reserve balance at December 31, 2007.

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

Ewan Property Site

The case *United States v. Lightman* (1:92-cv-4710 D.N.J.), described above for the D Imperio site, also involved the Ewan Property Site located in New Jersey. The agreement described above also included a settlement with respect to the past costs and future allocation percentage in said litigation for costs related to the past costs and allocation percentage at the Ewan site. The Company paid the settlement amount in the third quarter of 2007. The resolution of the Company s liability for this litigation did not have a material impact on the financial position, results of operations or cash flows of the Company.

In addition, the NJDEP filed a natural resource damages complaint in June 2007 against the Company and other entities regarding the Ewan site. The Company was served with the complaint in May 2008. The parties, including the Company, are engaged in discussions with NJDEP to resolve this litigation.

There is some monitoring and operational work continuing at the Ewan site. Based on current information, the Company believes that it has adequate reserves for claims associated with the Ewan site. However, actual costs could differ from current estimates.

Lightman Drum Company Superfund Site

The Company received a Section 104(e) Request for Information from USEPA dated March 21, 2000, regarding the Lightman Drum Company Superfund Site located in Winslow Township, New Jersey. The Company responded to this request on May 18, 2000. In addition, the Company received a Notice of Potential Liability and Request to Perform RI/FS dated June 30, 2000, from USEPA. The Company decided that it will participate in the performance of the RI/FS as a member of the Lightman Yard PRP Group. Due to the addition of other PRPs, the Company s allocation percentage decreased. However, the allocation has not yet been finalized by the Lightman Yard PRP Group.

The Feasibility Study was submitted to USEPA in December 2007. The PRPs who agreed to conduct the interim remedial action entered into an Administrative Settlement Agreement and Order on Consent for Removal Action with USEPA, and these PRPs also entered into a Supplemental Lightman Yard Participation and Interim Funding Agreement to fund the agreed-upon removal action. The Company paid a soil removal assessment upon execution of the agreements which did not have a material impact on the financial position, results of operations or cash flows of the Company. In December 2007, the Company received updated remediation cost estimates, which were considered in the Company s determination of its range of estimated possible losses and reserve balance at December 31, 2007.

The Company believes that based on current information it has adequate reserves for claims associated with the Lightman site. 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 $1.6 million for the Company s portion of environmental response costs through the second quarter of 2008 (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.

In addition, in response to the special notice letter received by the PRPs in June 2006 from USEPA seeking performance of an RI/FS at the site, certain PRPs, including the Company, signed an Administrative Settlement Agreement and Order on Consent for the RI/FS effective July 2007.

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.

10. POSTRETIREMENT BENEFIT PLANS

Defined Benefit Pension Plans

Components of Net Periodic Benefit Cost

	UNITED STATES			
	Three Months Ended September 30		Nine Months Ended September 30	
(Dollars in thousands)	2008	2007	2008	2007
Service cost	$	$ 56	$ 2	$ 325
Interest cost	1,632	1,579	4,893	4,721
Expected return on plan assets	(2,003)	(1,836)	(5,936)	(5,483)
Amortization of prior service cost		19		117
Amortization of net loss	149	304	449	920
Curtailment loss		1,325		1,325
Net periodic (benefit) cost	$ (222)	$ 1,447	$ (592)	$ 1,925

The 2007 curtailment loss reflected the July 2007 freezing of the Millsdale portion of the Retirement Plan for Millsdale Hourly and Anaheim Hourly Employees.

	UNITED KINGDOM			
	Three Months Ended September 30		Nine Months Ended September 30	
(Dollars in thousands)	2008	2007	2008	2007
Interest cost	$ 251	$ 246	$ 778	$ 726
Expected return on plan assets	(234)	(244)	(725)	(720)
Net periodic (benefit) cost	$ 17	$ 2	$ 53	$ 6

Employer Contributions

U.S. Plans

The Company expects to contribute approximately $507,000 to its U.S. qualified defined benefit pension plans in 2008 and to pay $95,000 in 2008 related to its unfunded non-qualified plans. As of September 30, 2008, $507,000 had been contributed to the qualified plans and $76,000 had been paid related to the non-qualified plans.

U.K. Plan

Stepan UK Limited expects to contribute approximately $381,000 to its defined benefit pension plan in 2008. As of September 30, 2008, $280,000 had been contributed to the plan.

Defined Contribution Plans

Defined contribution plan expense for the Company s retirement savings plans was $3,320,000 and $6,094,000, respectively, for the three and nine months ended September 30, 2008, compared to $1,125,000 and $3,183,000, respectively, for the three and nine months ended September 30, 2007. The large increases in quarter-to-quarter and year-to-year defined contribution pension expenses resulted from the acceleration of discretionary transition contributions. When the Company froze its U.S. salaried defined benefit pension plan in 2006, a funded defined contribution plan was established that provided for fixed Company contributions and additional discretionary transition contributions to employee retirement accounts. The additional discretionary transition contributions were instituted to partially compensate certain U.S. employees for the loss in benefits resulting from freezing the defined benefit plan. In September 2008, the Company s Board of Directors approved an acceleration of a portion of the transition contributions. As a result, $1,927,000 of additional transition contribution expense was recorded in the third quarter ended September 30, 2008. The contributions to the employees retirement accounts were determined as of September 30, 2008, and were paid on October 7, 2008.

Expenses related to the Company s profit sharing plan were $416,000 and $1,899,000, respectively, for the three and nine months ended September 30, 2008, compared to $75,000 and $743,000, respectively, for the three and nine months ended September 30, 2007.

11. EARNINGS PER SHARE

Below is the computation of basic and diluted earnings per share for the three and nine months ended September 30, 2008 and 2007.

	Three Months Ended September 30		**Nine Months Ended September 30**	
(In thousands, except per share amounts)	**2008**	**2007**	**2008**	**2007**
Computation of Basic Earnings per Share				
Net income	$ 17,000	$ 3,086	$ 35,508	$ 13,510
Deduct dividends on preferred stock	(192)	(197)	(580)	(591)
Income applicable to common stock	$ 16,808	$ 2,889	$ 34,928	$ 12,919
Weighted-average number of common shares outstanding	9,628	9,325	9,521	9,306
Basic earnings per share	$ 1.75	$ 0.31	$ 3.67	$ 1.39
Computation of Diluted Earnings per Share				
Net income	$ 17,000	$ 3,086	$ 35,508	$ 13,510
Weighted-average number of common shares outstanding	9,628	9,325	9,521	9,306
Add net shares issuable from assumed exercise of options (under treasury stock method) [(1)]	375	141	288	132
Add contingently issuable net shares related to performance stock awards (under treasury stock method)	54		18	
Add weighted-average shares issuable from assumed conversion of convertible preferred stock	637	653	641	654
Shares applicable to diluted earnings	10,694	10,119	10,468	10,092
Diluted earnings per share	$ 1.59	$ 0.31	$ 3.39	$ 1.34

(1) Options to purchase 247,768 and 248,701 shares of common stock were not included in the computations of earnings per share for the three and nine months ended September 30, 2007, because the options exercise prices were greater than the average market price for the common stock and their effect would have been antidilutive.

12. COMPREHENSIVE INCOME

Comprehensive income includes net income and all other non-shareholder changes in equity that are not reported in net income. Below is the Company s comprehensive income for the three and nine months ended September 30, 2008 and 2007.

	Three Months Ended September 30		Nine Months Ended September 30	
(Dollars in thousands)	**2008**	**2007**	**2008**	**2007**
Net income	$ 17,000	$ 3,086	$ 35,508	$ 13,510
Other comprehensive income:				
Foreign currency translation gains (losses)	(11,350)	3,780	(8,321)	9,057
Unrealized gains on securities, net of tax [1]		349		714
Pension liability adjustments, net of tax	92	852	276	1,290
Derivative instruments revaluation, net of tax	(2)			
Comprehensive income	$ 5,740	$ 8,067	$ 27,463	$ 24,571

[1] With its January 1, 2008, adoption of SFAS No. 159, the Company elected fair value accounting treatment for its mutual fund investment assets. Therefore, beginning January 1, 2008, changes in the fair values of the Company s mutual fund investment assets are included in net income.

13. GOODWILL IMPAIRMENT CHARGE

The Company tests its goodwill balances for impairment in the second quarter of each calendar year. The 2007 test indicated that the goodwill related to its United Kingdom subsidiary (Stepan UK) was impaired. Stepan UK is a reporting unit of the Company s surfactants reportable segment. The goodwill impairment reflected an estimated reduction in the fair value of Stepan UK s business as a result of lower discounted cash flow forecasts for the business. Improvements in the reporting unit s operating results had been lower than previous forecasts used to test for impairments. As a result of the impairment, the Company recorded a non-cash $3,467,000 charge against operating income for the three months ended June 30, 2007. The charge equaled the entire balance of Stepan UK s goodwill. The fair value of Stepan UK was estimated using the present value of future cash flows. No impairment of goodwill related to other Company reporting units was indicated by the 2008 annual test.

14. 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, 2008 and 2007 are summarized below:

(Dollars in thousands)	**Surfactants**	**Polymers**	**Specialty Products**	**Segment Totals**
For the three months ended September 30, 2008				
Net sales	$ 318,388	$ 103,518	$ 11,041	$ 432,947
Operating income	12,986	14,231 (2)	1,392	28,609