

STEPAN CO
Form 10-Q
May 02, 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 MARCH 31, 2013

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)

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Delaware
(State or other jurisdiction of
incorporation or organization)

36-1823834
(I.R.S. Employer
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 April 29, 2013
Common Stock, \$1 par value	22,090,909 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 March 31	
	2013	2012
Net Sales	\$ 456,546	\$ 465,269
Cost of Sales	383,846	388,485
Gross Profit	72,700	76,784
Operating Expenses:		
Selling	13,728	13,651
Administrative	19,351	16,952
Research, development and technical services	11,327	10,781
	44,406	41,384
Operating Income	28,294	35,400
Other Income (Expense):		
Interest, net	(2,179)	(2,604)
Loss from equity in joint ventures	(1,413)	(1,141)
Other, net (Note 13)	571	1,065
	(3,021)	(2,680)
Income Before Provision for Income Taxes	25,273	32,720
Provision for Income Taxes	6,276	10,356
Net Income	18,997	22,364
Net (Income) Loss Attributable to		
Noncontrolling Interests (Note 2)	37	(62)
Net Income Attributable to Stepan Company	\$ 19,034	\$ 22,302
Net Income Per Common Share Attributable to Stepan Company (Note 9):		
Basic	\$ 0.85	\$ 1.05
Diluted	\$ 0.83	\$ 0.98
Shares Used to Compute Net Income Per Common Share Attributable to Stepan Company (Note 9):		
Basic	22,464	21,022
Diluted	22,887	22,642
Dividends Declared Per Common Share	\$ 0.16	\$ 0.14

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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 Ended	
	March 31	
	2013	2012
Net income	\$ 18,997	\$ 22,364
Other comprehensive income (loss):		
Foreign currency translation adjustments (Note 10)	(4,416)	8,534
Pension liability adjustment, net of tax (Note 10)	863	582
Derivative instrument activity, net of tax (Note 10)	(12)	107
Other comprehensive income (loss)	(3,565)	9,223
Comprehensive income	15,432	31,587
Comprehensive (income) loss attributable to noncontrolling interests (Note 2)	35	(137)
Comprehensive income attributable to Stepan Company	\$ 15,467	\$ 31,450

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>	March 31, 2013	December 31, 2012
Assets		
Current Assets:		
Cash and cash equivalents	\$ 54,770	\$ 76,875
Receivables, net	281,480	255,858
Inventories (Note 6)	177,379	162,013
Deferred income taxes	9,738	9,876
Other current assets	19,662	18,456
Total current assets	543,029	523,078
Property, Plant and Equipment:		
Cost	1,210,078	1,200,355
Less: accumulated depreciation	786,488	778,333
Property, plant and equipment, net	423,590	422,022
Goodwill, net	7,137	7,199
Other intangible assets, net	8,183	8,778
Long-term investments (Note 3)	15,425	14,093
Other non-current assets	9,762	10,308
Total assets	\$ 1,007,126	\$ 985,478
Liabilities and Equity		
Current Liabilities:		
Current maturities of long-term debt (Note 12)	44,044	\$ 32,838
Accounts payable	150,727	141,668
Accrued liabilities	57,413	72,661
Total current liabilities	252,184	247,167
Deferred income taxes	7,300	9,200
Long-term debt, less current maturities (Note 12)	149,872	149,564
Other non-current liabilities	102,881	98,667
Commitments and Contingencies (Note 7)		
Equity:		
5-1/2% convertible preferred stock, cumulative, voting, without par value; authorized 2,000,000 shares; issued and outstanding 61,935 shares in 2013 and 2012	1,548	1,548
Common stock, \$1 par value; authorized 30,000,000 shares; Issued 25,277,548 shares in 2013 and 25,141,610 shares in 2012	25,278	25,142
Additional paid-in capital	127,959	125,003
Accumulated other comprehensive loss (Note 10)	(41,817)	(38,250)
Retained earnings	435,964	420,472
Less: Common treasury stock, at cost, 3,188,039 shares in 2013 and 3,175,638 shares in 2012	(55,903)	(54,930)

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Total Stepan Company stockholders' equity	493,029	478,985
Noncontrolling interests (Note 2)	1,860	1,895
Total equity	494,889	480,880
Total liabilities and equity	\$ 1,007,126	\$ 985,478

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>	Three Months Ended March 31	
	2013	2012
Cash Flows From Operating Activities		
Net income	\$ 18,997	\$ 22,364
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	13,419	12,226
Deferred compensation	4,933	3,499
Realized and unrealized gain on long-term investments	(898)	(1,446)
Stock-based compensation	(219)	628
Deferred income taxes	(2,524)	(814)
Other non-cash items	1,708	916
Changes in assets and liabilities:		
Receivables, net	(31,815)	(23,346)
Inventories	(16,488)	(23,222)
Other current assets	(1,097)	(1,691)
Accounts payable and accrued liabilities	5,460	18,054
Pension liabilities	456	(693)
Environmental and legal liabilities	(28)	376
Deferred revenues	(101)	(292)
Excess tax benefit from stock options and awards	(1,705)	(1,878)
Net Cash Provided By (Used In) Operating Activities	(9,902)	4,681
Cash Flows From Investing Activities		
Expenditures for property, plant and equipment	(20,980)	(21,322)
Sale of mutual funds	390	535
Other, net	(2,322)	(1,582)
Net Cash Used In Investing Activities	(22,912)	(22,369)
Cash Flows From Financing Activities		
Revolving debt and bank overdrafts, net	17,542	1,974
Other debt repayments	(5,190)	(1,458)
Dividends paid	(3,542)	(3,072)
Company stock repurchased		(500)
Stock option exercises	1,875	1,896
Excess tax benefit from stock options and awards	1,705	1,878
Payment to noncontrolling interest (Note 14)		(2,000)
Other, net	(1,059)	(1,258)
Net Cash Provided By (Used In) Financing Activities	11,331	(2,540)
Effect of Exchange Rate Changes on Cash	(622)	775
Net Decrease in Cash and Cash Equivalents	(22,105)	(19,453)
Cash and Cash Equivalents at Beginning of Period	76,875	84,099
Cash and Cash Equivalents at End of Period	\$ 54,770	\$ 64,646

Supplemental Cash Flow Information

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Cash payments of income taxes, net of refunds	\$ 2,999	\$ 3,635
Cash payments of interest	\$ 652	\$ 912

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

STEPAN COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

March 31, 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 March 31, 2013, and its results of operations and cash flows for the three months ended March 31, 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. RECONCILIATIONS OF EQUITY

Below are reconciliations of total equity, Company equity and equity attributable to noncontrolling interests for the three months ended March 31, 2013 and 2012:

<i>(In thousands)</i>	Total Equity	Stepan Company Equity	Noncontrolling Interests Equity ⁽³⁾
Balance at January 1, 2013	\$ 480,880	\$ 478,985	\$ 1,895
Net income	18,997	19,034	(37)
Dividends	(3,542)	(3,542)	
Common stock purchases ⁽¹⁾	(1,059)	(1,059)	
Stock option exercises	1,875	1,875	
Defined benefit pension adjustments, net of tax	863	863	
Translation adjustments	(4,416)	(4,418)	2
Derivative instrument activity, net of tax	(12)	(12)	
Other ⁽²⁾	1,303	1,303	
Balance at March 31, 2013	\$ 494,889	\$ 493,029	\$ 1,860

<i>(In thousands)</i>	Total Equity	Stepan Company Equity	Noncontrolling Interests Equity ⁽³⁾
Balance at January 1, 2012	\$ 405,465	\$ 401,211	\$ 4,254
Net income	22,364	22,302	62
Purchase of remaining interest in Stepan Philippines, Inc. from noncontrolling interest	(2,000)	748	(2,748)
Dividends	(3,072)	(3,072)	
Common stock purchases ⁽¹⁾	(1,761)	(1,761)	
Stock option exercises	1,896	1,896	
Defined benefit pension adjustments, net of tax	582	582	
Translation adjustments	8,534	8,459	75
Derivative instrument activity, net of tax	107	107	
Other ⁽²⁾	2,567	2,567	
Balance at March 31, 2012	\$ 434,682	\$ 433,039	\$ 1,643

- (1) Includes the value of Company shares purchased in the open market and 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.
- (2) Primarily comprised of activity related to stock-based compensation, deferred compensation and excess tax benefits.
- (3) 2013 includes noncontrolling interest in the Company's China joint venture. 2012 includes noncontrolling interests in the Company's China and Philippines joint ventures.

3. FINANCIAL INSTRUMENTS

The following describe the financial instruments held by the Company at March 31, 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 included the foreign currency exchange and interest rate contracts discussed in Note 4. 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 tables that follow these 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 8). 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 tables that follow these 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 March 31, 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>	March 31, 2013	December 31, 2012
Fair value	\$ 207,004	\$ 194,620
Carrying value	193,916	182,402

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

<i>(In thousands)</i>	March 2013	Level 1	Level 2	Level 3
Mutual fund assets	\$ 15,425	\$ 15,425	\$	\$
Derivative assets:				
Foreign currency contracts	10		10	
Total assets at fair value	\$ 15,435	\$ 15,425	\$ 10	\$
Derivative liabilities:				
Foreign currency contracts	\$ 15	\$	\$ 15	\$
Interest rate contracts	43		43	
Total liabilities at fair value	\$ 58	\$	\$ 58	\$

<i>(In thousands)</i>	December 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	\$

4. 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 Company uses these contracts to manage its 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 March 31, 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 U.S. dollar equivalent amounts of \$18,099,000 and \$16,258,000, respectively.

The Company also holds forward foreign currency exchange contracts that are designated as a cash flow hedge. The Company uses 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 are denominated in a currency other than the Singapore location's functional currency. The Company expects to complete its hedging activity for the progress payments by the end of the second quarter of 2013. The forward foreign exchange contracts are 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 are recognized as gains or losses in other comprehensive income, to the extent effective. Once the constructed asset is complete and placed into service, the accumulated gains or losses will be 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 March 31, 2013, that is expected to be reclassified into earnings in the next 12 months is insignificant. The Company had open forward foreign currency exchange contracts designated as cash flow hedges with U.S. dollar equivalent amounts of \$1,177,000 and \$1,197,000 at March 31, 2013, and December 31, 2012, respectively.

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 \$2,693,000 at March 31, 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 March 31, 2013, and December 31, 2012, and derivative instrument gains and losses were immaterial. For amounts reclassified out of AOCI into earnings for the three month periods ended March 31, 2013 and 2012, see Note 10.

5. STOCK-BASED COMPENSATION

On March 31, 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 (income)/expense recorded for all stock options, stock awards and SARs was as follows:

<i>(In thousands)</i>	Three Months Ended	
	March 31	
	2013	2012
	\$(219)	\$ 628

Compensation income in the first quarter 2013 resulted from management's assessment that the profitability targets for the performance stock awards that vest on December 31, 2013, would not be achieved.

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

<i>(In thousands)</i>	March 31, 2013	December 31, 2012
Stock options	\$ 1,455	\$ 627
Stock awards	2,749	1,669
SARs	2,414	815

The increases in unrecognized compensation costs for stock options, stock awards and SARs reflected the first quarter 2013 grants of:

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

The unrecognized compensation costs at March 31, 2013, are expected to be recognized over weighted-average periods of 1.60 years, 2.50 years and 1.60 years for stock options, stock awards and SARs, respectively.

6. INVENTORIES

The composition of inventories was as follows:

<i>(In thousands)</i>	March 31, 2013	December 31, 2012
Finished products	\$ 118,149	\$ 113,589
Raw materials	59,230	48,424
Total inventories	\$ 177,379	\$ 162,013

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 \$33,953,000 and \$33,868,000 higher than reported at March 31, 2013, and December 31, 2012, respectively.

7. 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 March 31, 2013, the Company has estimated a range of possible environmental and legal losses of \$10.2 million to \$29.0 million. At March 31, 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 \$15.3 million and \$15.4 million, respectively. During the first three months of 2013 cash outlays related to legal and environmental matters approximated \$0.6 million compared to \$0.8 million in the first three 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 March 31, 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 is awaiting the issuance of a Record of Decision (ROD) from USEPA.

The Company believes its recorded liability for claims associated with remediation of chemical contamination at the Maywood site is adequate. 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. 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 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 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 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 \$2.1 million for the Company's portion of environmental response costs through the fourth quarter of 2012 (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.

8. 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>	UNITED STATES		UNITED KINGDOM	
	Three Months Ended		Three Months Ended	
	March 31		March 31	
	2013	2012	2013	2012
Interest cost	\$ 1,607	\$ 1,736	\$ 223	\$ 209
Expected return on plan assets	(2,202)	(2,102)	(234)	(220)
Amortization of net actuarial loss	1,306	931	71	11
Net periodic benefit cost	\$ 711	\$ 565	\$ 60	\$

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 21st 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 March 31, 2013, \$107,000 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 March 31, 2013, \$279,000 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 plan were \$1,077,000 for the three months ended March 31, 2013, compared to \$1,054,000 for three months ended March 31, 2012.

Expenses related to the Company's profit sharing plan were \$1,325,000 and \$1,529,000, for the three months ended March 31, 2013 and 2012, respectively.

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 March 31, 2013, the balance of the trust assets was \$1,694,000, which equaled the balance of the supplemental plan liabilities (see the long-term investments section in Note 3 for further information regarding the Company's mutual fund assets).

9. EARNINGS PER SHARE

Below are the computations of basic and diluted earnings per share for the three months ended March 31, 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	
	March 31	
	2013	2012
<u>Computation of Basic Earnings per Share</u>		
Net income attributable to Stepan Company	\$ 19,034	\$ 22,302
Deduct dividends on preferred stock	21	178
Income applicable to common stock	\$ 19,013	\$ 22,124
Weighted-average number of shares outstanding	22,464	21,022
Basic earnings per share	\$ 0.85	\$ 1.05
<u>Computation of Diluted Earnings per Share</u>		
Net income attributable to Stepan Company	\$ 19,034	\$ 22,302
Weighted-average number of shares outstanding	22,464	21,022
Add weighted-average net shares issuable from assumed exercise of options (under treasury stock method) ⁽¹⁾	275	430
Add weighted-average net shares related to unvested stock awards (under treasury stock method)	7	6
Add weighted-average shares issuable from assumed conversion of convertible preferred stock	141	1,184
Weighted-average shares applicable to diluted earnings	22,887	22,642
Diluted earnings per share	\$ 0.83	\$ 0.98

⁽¹⁾ Options to purchase 49,776 and 65,264 shares of Company common stock were excluded from the computation of diluted earnings per share for the three months ended March 31, 2013 and March 31, 2012, respectively. The options' exercise prices were greater than the average market price for the common stock and their effect would have been antidilutive.

10. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The changes in the Company's accumulated other comprehensive income (loss) (AOCI) by component (net of income taxes) for the three month period ended March 31, 2013, are presented below:

<i>(In thousands)</i>	Foreign Currency Translation Adjustments	Defined Benefit Pension Plan Adjustments	Cash Flow Hedge Adjustments	Total
Balance at December 31, 2012	\$ (2,886)	\$ (35,498)	\$ 134	\$ (38,250)
Other comprehensive income before reclassifications	(4,418)		(21)	(4,439)
Amounts reclassified from AOCI		863	9	872
Net current-period other comprehensive income	(4,418)	863	(12)	(3,567)
Balance at March 31, 2013	\$ (7,304)	\$ (34,635)	\$ 122	\$ (41,817)

Information regarding the reclassifications out of AOCI for the three month periods ended March 31, 2013 and 2012, is displayed below:

<i>(In thousands)</i>	Amount Reclassified from AOCI (a)		Affected Line Item in Consolidated Statements of Income
AOCI Components	2013	2012	
Amortization of defined benefit pension actuarial losses	\$ (1,377)	\$ (942)	(b)
	514	360	Tax (expense) or benefit
	\$ (863)	\$ (582)	Net of tax
Gains and losses on cash flow hedges:			
Interest rate contracts	\$ (10)	\$ (2)	Interest, net
Foreign exchange contracts	(3)		Cost of sales
	(13)	(2)	Total before tax
	4		Tax (expense) or benefit
	\$ (9)	\$ (2)	Net of tax
Total reclassifications for the period	\$ (872)	\$ (584)	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 8 for additional details).

11. SEGMENT REPORTING

The Company has three reportable segments: surfactants, polymers and specialty products. Segment operating results for the three months ended March 31, 2013 and 2012, are summarized below:

<i>(In thousands)</i>	Surfactants	Polymers	Specialty Products	Segment Totals
<u>For the three months ended March 31, 2013</u>				
Net sales	\$ 339,973	\$ 95,998	\$ 20,575	\$ 456,546
Operating income	29,652	10,764	2,832	43,248
<u>For the three months ended March 31, 2012</u>				
Net sales	\$ 347,156	\$ 96,749	\$ 21,364	\$ 465,269
Operating income	32,992	11,751	3,895	48,638

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

<i>(In thousands)</i>	Three Months Ended	
	March 31, 2013	March 31, 2012
Operating income segment totals	\$ 43,248	\$ 48,638
Unallocated corporate expenses ^(a)	(14,954)	(13,238)
Total operating income	28,294	35,400
Interest expense, net	(2,179)	(2,604)
Loss from equity in joint ventures	(1,413)	(1,141)
Other, net	571	1,065
Consolidated income before income taxes	\$ 25,273	\$ 32,720

^(a) 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.

12. DEBT

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

<i>(In thousands)</i>	Maturity Dates	March 31, 2013	December 31, 2012
Unsecured private placement notes			
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	12,856	12,856
Unsecured U.S. bank debt			
	2017	2,600	
Debt of foreign subsidiaries			
Secured bank term loans, foreign currency			
	2013-2016	7,694	9,531
Secured bank term loan, U.S. dollars			
			3,500
Unsecured bank debt, U.S. dollars			
	2014	3,706	
Unsecured bank debt, foreign currency			
	2014	1,507	
Other loans, foreign currency			
	2013-2015	26,267	17,229
Total debt		\$ 193,916	\$ 182,402
Less current maturities		44,044	32,838
Long-term debt		\$ 149,872	\$ 149,564

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 March 31, 2013, the Company had outstanding letters of credit totaling \$2,877,000 and outstanding debt totaling \$2,600,000 under this agreement. There was \$119,523,000 available under the revolving credit agreement as of March 31, 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 \$125,422,000 and \$114,204,000 at March 31, 2013, and December 31, 2012, respectively.

13. OTHER, NET

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

<i>(In thousands)</i>	Three Months Ended	
	March 31	
	2013	2012
Foreign exchange loss	\$ (411)	\$ (385)
Investment income	84	4
Realized and unrealized gain on investments	898	1,446
Other, net	\$ 571	\$ 1,065

14. 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.

15. SUBSEQUENT EVENT

In April 2013, the Company reached an agreement to acquire the North American Polyester Resins business from Bayer Material Science. The acquisition is to include a 21,000-ton production facility in Columbus, Georgia. The facility also houses a modern research and development laboratory for customer technical support and new product development. The acquisition is expected to diversify the Company's polyol product offering and accelerate Company growth in CASE (coatings, adhesives, sealants and elastomers) and PUSH (polyurethane systems house) applications. The business to be acquired, which will become a part of the Company's polymer segment, has annual sales of approximately \$64 million. The closing date of the transaction is expected to occur in June 2013. Based on the range for the expected purchase price, the Company believes it has sufficient cash available on hand and through its committed revolving credit agreement to fund the acquisition.

16. 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 is not expected to 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 beginning 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.

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, project, possible, potential, should and similar expressions. Actual results may vary.

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 74 percent of consolidated net sales in the first quarter 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). 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 21 percent of consolidated net sales in the first quarter 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, phthalic anhydride is used internally in the production of polyols. In the U.S., polymer product lines are manufactured at the Company's Millsdale, Illinois, site. In Europe, polyols are manufactured at the Company's subsidiaries in Germany and Poland. In Asia, polyols are produced at 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 5 percent of consolidated net sales in the first quarter of 2013, include flavors, emulsifiers and solubilizers used in the food and pharmaceutical industries. Specialty products are primarily manufactured at the Company's Maywood, New Jersey, site and, in some instances, at outside contractors.

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)		
	For the Three Months		
	Ended March 31		
	2013	2012	Change
Deferred Compensation (Administrative expense)	(\$4.9)	(\$3.5)	(\$1.4) ⁽¹⁾
Realized/Unrealized Gains on Investments (Other, net)	0.8	1.3	(0.5)
Investment Income (Other, net)	0.1		0.1
Pretax Income Effect	(\$4.0)	(\$2.2)	(\$1.8)

⁽¹⁾ See the Corporate Expenses section of this management's discussion and analysis for details regarding the quarter-over-quarter change 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 table presents the effects that foreign currency translation had on the quarter-over-quarter changes in consolidated net sales and various income line items between the quarters ended March 31, 2013 and 2012: