STEPAN CO
Form 10-K
February 26, 2014
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(MARK ONE)

(X) ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE FISCAL YEAR ENDED DECEMBER 31, 2013

OR

( ) 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 incorporation or organization)	(I.R.S. Employer Identification Number)
Edens and Winnetka Road, Northfield, Illinois	60093
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number including area code: 847-446-7500

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

Title of Each Class	Name of Each Exchange on Which Registered
Common Stock, $1 par value	New York Stock Exchange

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

None

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

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

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 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 X No ____

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, 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 X 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 X

Aggregate market value at June 30, 2013, of voting and non-voting common stock held by nonaffiliates of the registrant: $1,114,938,768*

Number of shares outstanding of each of the registrant s classes of common stock as of January 31, 2014:

Class	Outstanding at January 31, 2014
Common Stock, $1 par value	22,337,638

Documents Incorporated by Reference

Part of Form 10-K	Document Incorporated
Part III, Items 10-14	Portions of the Proxy Statement for Annual Meeting of Stockholders to be held April 29, 2014.

* Based on reported ownership by all directors and executive officers at June 30, 2013.

Table of Contents

STEPAN COMPANY

ANNUAL REPORT ON FORM 10-K

December 31, 2013

Table of Contents

PART I

Item 1. Business

Stepan Company, which was incorporated under the laws of the state of Delaware on February 19, 1959, and its subsidiaries (the Company) produce specialty and intermediate chemicals, which are sold to other manufacturers and used in a variety of end products. The Company has three reportable segments: surfactants, polymers and specialty products.

Surfactants are chemical agents that affect the interaction between two surfaces; they can provide actions such as detergency (i.e., the ability of water to remove soil from another surface), wetting and foaming, dispersing, emulsification (aiding two dissimilar liquids to mix), demulsification, viscosity modifications and biocidal disinfectants. Surfactants are the basic cleaning agent in detergents for washing clothes, dishes, carpets, fine fabrics, floors and walls. Surfactants are also used for the same purpose in shampoos, body wash and conditioners, fabric softeners, toothpastes, cosmetics and other personal care products. Commercial and industrial applications include emulsifiers for agricultural products, emulsion polymers such as floor polishes and latex foams and coatings, wetting and foaming agents for wallboard manufacturing, surfactants for enhanced oil recovery and biodiesel.

Polymers, which includes two primary product lines, polyols and phthalic anhydride, are used in multiple types of specialty polymers. Polyurethane polyols are used in the manufacture of rigid foam for thermal insulation in the construction industry. They are also a base for raw material for coatings, adhesives, sealants and elastomers. Phthalic anhydride is used in polyester resins, alkyd resins, and plasticizers for applications in construction materials and components of automotive, boating, and other consumer products and internally in the Company s polyols.

In June 2013, the Company purchased the North American polyester resins business of Bayer MaterialScience LLC (BMS). 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. The acquired business, which includes both liquid and powdered resins, diversifies the Company s polyol product portfolio and is expected to accelerate Company growth in coatings, adhesives, sealants and elastomers (CASE) and polyurethane systems house (PUSH) applications.

Specialty products are chemicals used in food, flavoring, nutritional supplement and pharmaceutical applications.

MARKETING AND COMPETITION

Principal customers for surfactants are manufacturers of detergents, shampoos, lotions, fabric softeners, toothpastes and cosmetics. In addition, surfactants are sold to the producers of agricultural emulsifiers and lubricating products. Surfactants are also sold into the enhanced oil recovery and biodiesel end markets. Polymers are used in the construction and refrigeration industries, as well as in applications for the coatings, adhesives, sealants, elastomers and flexible foam industries. Polymers are also used by automotive, boating and other consumer product companies. Specialty products are used primarily by food, nutritional supplement and pharmaceutical manufacturers.

Table of Contents

The Company does not sell directly to the retail market, but sells to a wide range of manufacturers in many industries and has many competitors. The principal methods of competition are product performance, price, technical assistance and adaptability to the specific needs of individual customers. These factors allow the Company to compete on a basis other than price alone, reducing the severity of competition as experienced in the sales of commodity chemicals having identical performance characteristics. The Company is one of the leading merchant producers of surfactants in the Americas. In the case of surfactants, much of the Company s competition comes from several large global and regional producers and the internal divisions of larger customers. In the manufacture of polymers, the Company competes with the chemical divisions of several large companies, as well as with other small specialty chemical manufacturers. In specialty products, the Company competes with several large firms plus numerous small companies.

MAJOR CUSTOMER AND BACKLOG

The Company did not have any one customer whose business represented more than 10 percent of the Company s consolidated revenue in 2013, 2012 or 2011. The Company has contract arrangements with certain customers, but volumes are generally contingent on purchaser requirements. Much of the Company s business is essentially on a spot delivery basis and does not involve a significant backlog.

ENERGY SOURCES

Substantially all of the Company s manufacturing plants operate on electricity and interruptible natural gas. During peak heating demand periods, gas service to all plants may be temporarily interrupted for varying periods ranging from a few days to several months. The plants operate on fuel oil during these periods of interruption. The Company s operations have not experienced any plant shutdowns or adverse effects upon its business in recent years that were caused by a lack of available energy sources, other than temporary service interruptions brought on by mechanical failure.

RAW MATERIALS

The most important raw materials used by the Company are petroleum or plant based. For 2014, the Company has contracts with suppliers that cover the majority of its forecasted requirements for major raw materials and is not substantially dependent upon any one supplier.

RESEARCH AND DEVELOPMENT

The Company maintains an active research and development program to assist in the discovery and commercialization of new knowledge with the intent that such efforts will be useful in developing a new product or in bringing about a significant improvement to an existing product or process. Total expenses for research and development during 2013, 2012 and 2011 were $28.8 million, $28.0 million, and $25.1 million, respectively. The remainder of research, development and technical service expenses reflected in the consolidated statements of income relates to technical services, which include routine product testing, analytical methods development and sales support service.

ENVIRONMENTAL COMPLIANCE

Compliance with applicable country, state and local regulations regarding the discharge of materials into the environment, or otherwise relating to the protection of the environment, resulted in capital expenditures by the Company of approximately $4.7 million during 2013. These expenditures represented approximately 5 percent of the Company s total 2013 capital expenditures. Capitalized environmental expenditures are depreciated and charged on a straight-line basis to pretax earnings 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 our manufacturing locations were approximately $18.7 million in 2013. Compliance with such regulations is not expected to have a material adverse effect on the Company s earnings and competitive position in the foreseeable future.

EMPLOYMENT

At December 31, 2013 and 2012, the Company employed 2,015 and 1,920 persons, respectively. The Company has collective bargaining agreements with employees at some of its manufacturing locations. While the Company has experienced occasional work stoppages as a result of the collective bargaining process and may experience some work stoppages in the future, management believes that it will be able to negotiate all labor agreements on satisfactory terms. Past work stoppages have not had a significant impact on the Company s operating results. Overall, the Company believes it has good relationships with its employees. In 2013, the Company negotiated a new four-year contract at its largest manufacturing site.

FOREIGN OPERATIONS AND REPORTING SEGMENTS

See Note 18, Segment Reporting, of the Consolidated Financial Statements (Item 8 of this Form 10-K).

WEBSITE

The Company s website address is www.stepan.com. The Company makes available free of charge on or through its website its code of conduct, annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission. The website also includes the Company s corporate governance guidelines and the charters for the audit, nominating and corporate governance and compensation and development committees of the Board of Directors.

Table of Contents

Executive Officers of the Registrant

The Company s executive officers are elected annually by the Board of Directors at the first meeting following the Annual Meeting of Stockholders to serve through the next annual meeting of the Board and until their respective successors are duly elected and qualified.

The executive officers of the Company, their ages and certain other information as of February 26, 2014, are as follows:

Name	Age	Title	Year First Elected Officer
F. Quinn Stepan	76	Chairman	1967
F. Quinn Stepan, Jr.	53	President and Chief Executive Officer	1997
John V. Venegoni	55	Vice President and General Manager Surfactants	1999
Robert J. Wood	56	Vice President and General Manager Polymers	2001
Frank Pacholec	58	Vice President, Research and Development and Corporate Sustainability Officer	2003
Gregory Servatius	54	Vice President, Human Resources	2006
H. Edward Wynn	53	Vice President, General Counsel and Secretary	2007
Scott C. Mason	55	Vice President, Supply Chain	2010
Scott D. Beamer	42	Vice President and Chief Financial Officer	2013

F. Quinn Stepan is an executive officer of the Company and Chairman of the Company s Board of Directors. He served the Company as Chairman and Chief Executive Officer from October 1984 through December 2005. He served as President from 1973 until February 1999.

F. Quinn Stepan, Jr., has served the Company as President and Chief Executive Officer since January 2006. He served the Company as President and Chief Operating Officer from 1999 through 2005. From January 1997 until February 1999 he served as Vice President and General Manager Surfactants. From May 1996 until January 1997 he served as Vice President Global Laundry and Cleaning Products. From May 1992 until May 1996 he served as Director Business Management.

John V. Venegoni has served the Company as Vice President and General Manager Surfactants since February 1999. From May 1996 until February 1999 he served as Director Global Personal Care. From May 1992 until May 1996 he served as Senior Business Manager Consumer Products.

Robert J. Wood has served the Company as Vice President and General Manager Polymers since January 2001. From March 1996 until January 2001, he served as Director Polyols. From April 1988 until March 1996, he served as Business Manager Polyols. Mr. Wood has announced his intention to retire effective April 4, 2014. Arthur W. Mergner, currently Vice President, North America Polymers, is expected to serve as Vice President and General Manager Polymers effective upon Mr. Wood s retirement.

Table of Contents

Frank Pacholec has served the Company as Vice President, Research and Development since April 2003. In May 2010 he was also appointed as the Company s Corporate Sustainability Officer.

Gregory Servatius has served the Company as Vice President, Human Resources since February 2006. From April 2003 until January 2006, he served as Vice President, Surfactant Sales. From October 2001 until April 2003, he served as Vice President Functional Products. From 1998 to 2001, he served as the Managing Director of Stepan s European operation.

H. Edward Wynn has served the Company as Vice President, General Counsel and Secretary since January 9, 2007.

Scott C. Mason has served the Company as Vice President, Supply Chain since March 10, 2010. From January 2006 until December 2009, he served as Senior Vice President Global Supply Chain and President, Alternative Channels of Nalco Company.

Scott D. Beamer has served the Company as Vice President and Chief Financial Officer since August 15, 2013. From January 2012 until July 2013, he served as Assistant Corporate Controller at PPG Industries, Inc. From June 2008 until December 2011 he served as Chief Financial Officer and Director of Finance PPG Europe at PPG Industries, Inc.

James E. Hurlbutt, who served the Company as Vice President and Chief Financial officer from February 2008 until August 2013, retired in November 2013 following a period to transfer his responsibilities to Scott D. Beamer.

Table of Contents

Item 1A. Risk Factors

The following discussion identifies the most significant factors that may materially and adversely affect the Company s business, financial condition, results of operations and cash flows. These and other factors, many of which are beyond the Company s control, may cause future results of operations to differ materially from those currently expected or desired. The following information should be read in conjunction with Part II, Item 7, Management Discussion and Analysis and the consolidated financial statements and related notes included in this Form 10-K.

Disruptions in production at our manufacturing facilities, both planned and unplanned, may have a material impact on our business, financial position, results of operations and cash flows.

Manufacturing facilities in the Company s industry are subject to planned and unplanned production shutdowns, turnarounds and outages. Unplanned production disruptions may occur for external reasons including natural disasters, weather, disease, strikes, transportation interruption, government regulation, political unrest or terrorism, or internal reasons, such as fire, unplanned maintenance or other manufacturing problems. Alternative facilities with sufficient capacity may not be available, may cost substantially more or may take a significant time to increase production or qualify with Company customers, each of which could negatively impact the Company s business, financial position, results of operations and cash flows. Long-term production disruptions may cause Company customers to seek alternative supply, which could further adversely affect Company profitability.

Some of the Company s products cannot currently be made, or made in the volume required, at more than one of the Company s locations. For some of these products, the Company has access to external market suppliers, but the Company cannot guarantee that these products will be available to it in amounts sufficient to meet its requirements or at a cost that is competitive with the Company s cost of manufacturing these products. While the Company maintains insurance coverage, there can be no assurance that it would be sufficient to cover any or all losses resulting from the occurrence of any of these events or that insurance carriers would not deny coverage for these losses even if they are insured. There is also a risk, beyond the reasonable control of the Company, that an insurance carrier may not have the financial resources to cover an insurable loss. As a result, the occurrence of any of these events could have a material adverse effect on the Company s business, financial position, results of operations and cash flows.

The Company faces significant global competition in each of its operating segments. If the Company cannot successfully compete in the marketplace, its profitability, business, financial position, results of operations and cash flows may be materially and adversely affected.

The Company faces significant competition from numerous global companies as well as national, regional and local companies in the markets it serves. In addition, some of the Company s customers have internal manufacturing capabilities that allow them to achieve make-versus-buy economics, which may result at times in the Company gaining or losing business with these customers in volumes that could adversely affect its profitability.

To achieve expected profitability levels, the Company must, among other things, maintain the service levels, product quality and performance and competitive pricing necessary to retain existing customers and attract new customers. The Company s inability to do so could place it at a competitive disadvantage relative to its competitors, and if the Company cannot successfully compete in the marketplace, its business, financial position, results of operations and cash flows may be materially and adversely affected.

The volatility of raw material, natural gas and electricity costs as well as any disruption in their supply may materially and adversely affect the Company s business, financial position, results of operations and cash flows.

The costs of raw materials, natural gas and electricity represent a substantial portion of the Company s operating costs. The principal raw materials used in the Company s products are petroleum-based or plant-based. Natural gas is used in the Company s manufacturing sites primarily to generate steam for its manufacturing processes. The prices of many of these raw materials have recently been very volatile. These fluctuations in prices may be affected by supply and demand factors, such as general economic conditions, manufacturers ability to meet demand, restrictions on the transport of raw material (some of which may be viewed as hazardous), currency exchange rates, political instability and terrorist attacks, all of which are beyond the Company s control. The Company may not be able to pass increased raw material and natural gas prices on to customers through increases in product prices as a result of arrangements the Company has with certain customers and competitive pressures in the market. If the Company is unable to minimize the effects of increased raw material and energy costs or pass such increased costs on to customers, its business, financial position, results of operations and cash flows may be materially and adversely affected.

The Company relies heavily on third party transportation to deliver raw materials to Company manufacturing facilities and ship products to Company customers. Disruptions in transportation or significant changes in transportation costs could affect the Company s operating results.

The Company relies heavily on railroads, barges and other over-the-road shipping methods to transport raw materials to its manufacturing facilities and to ship finished product to customers. Transport operations are exposed to various risks, such as extreme weather conditions, work stoppages and operating hazards, as well as interstate transportation regulations. If the Company is unable to ship finished product or unable to obtain raw materials due to transportation problems, or if there are significant changes in the cost of these services, the Company may not be able to arrange efficient alternatives and timely means to obtain raw materials or ship product, which could result in an adverse effect on Company revenues, costs and operating results.

Table of Contents

Customer product reformulations can reduce the demand for the Company s products.

The Company s products are used in a broad range of customer product applications. Customer product reformulations may lead to reduced consumption of Company-produced products or make some Company products unnecessary. It is imperative that the Company develops new products to replace the sales of products that mature and decline in use. The Company s business, financial position, results of operations and cash flows could be materially and adversely affected if the Company is unable to manage successfully the maturation of existing products and the introduction of new products.

If the Company is unable to keep and protect its intellectual property rights, the Company s ability to compete may be negatively impacted.

The Company relies on intellectual property rights for the manufacture, distribution and sale of its products in all three of its reportable segments. Although most of the Company s intellectual property rights are registered in the United States and in the foreign countries in which it operates, the Company may not be able to assert these rights successfully in the future or guarantee that they will not be invalidated, circumvented or challenged. Other parties may infringe on the Company s intellectual property rights, which may dilute the value of such rights. Any infringement on the Company s intellectual property rights would also likely result in diversion of management s time and the Company s resources to protect these rights through litigation or otherwise. In addition, the laws of some foreign countries may not protect the Company s intellectual property rights to the same extent as the laws of the United States. Any loss of protection of these intellectual property rights could adversely affect the future financial position, results of operations and cash flows of the Company.

The Company is subject to risks related to its operations outside the U.S.

The Company has substantial operations outside the U.S. In the year ended December 31, 2013, the Company s sales outside of the U.S. constituted approximately 40 percent of the Company s net sales. In addition to the risks described in this Annual Report on Form 10-K that are common to both the Company s U.S. and non-U.S. operations, the Company faces, and will continue to face, risks related to the Company s foreign operations such as:

- compliance with U.S. laws affecting operations outside of the U.S., such as the Foreign Corrupt Practices Act;
- foreign currency fluctuations;
- unstable political, economic, financial and market conditions;
- import and export license requirements;
- trade restrictions;

increases in tariffs and taxes;

high levels of inflation;

restrictions on repatriating foreign profits back to the U.S.;

greater difficulty collecting accounts receivable and longer payment cycles;

Table of Contents

- less favorable intellectual property laws;
- changes in foreign laws and regulations; and
- changes in labor conditions and difficulties in staffing and managing international operations.

All of these risks have affected the Company s business in the past and may have a material adverse effect on the Company s business, financial position, results of operations and cash flows in the future.

Fluctuations in foreign currency exchange rates could affect Company financial results.

The Company is also exposed to fluctuations in exchange rates. The Company s results of operations are reported in U.S. dollars. However, outside the U.S., the Company s sales and costs are denominated in a variety of currencies including the European euro, British pound, Canadian dollar, Mexican peso, Colombian peso, Philippine peso, Brazilian real, Polish zloty, Singapore dollar and Chinese RMB. Fluctuations in exchange rates may materially and adversely affect the Company s business, financial position, results of operations and cash flows.

In all jurisdictions in which the Company operates, the Company is also subject to laws and regulations that govern foreign investment, foreign trade and currency exchange transactions. These laws and regulations may limit the Company s ability to repatriate cash as dividends or otherwise to the U.S. and may limit the Company s ability to convert foreign currency cash flows into U.S. dollars. A weakening of the currencies in which the Company generates sales relative to the foreign currencies in which the Company s costs are denominated may lower the Company s operating profits and cash flows.

The Company is subject to a variety of environmental, health and safety and product registration laws that expose it to potential financial liability and increased operating costs.

The Company s operations are regulated under a number of federal, state, local and foreign environmental, health and safety laws and regulations that govern, among other things, the discharge of hazardous materials into the air, soil and water as well as the use, handling, storage and disposal of these materials. These laws and regulations include, but are not limited to, the U.S. Clean Air Act, the Clean Water Act, the Resource Conservation and Recovery Act, the Comprehensive Environmental Response, Compensation and Liability Act, as well as analogous state, local and foreign laws, and the Registration, Evaluation, Authorization and Restriction of Chemical Substances Act (REACH). Compliance with these environmental laws and regulations is a major consideration for the Company because the Company uses hazardous materials in some of the Company s manufacturing processes. In addition, compliance with environmental laws could restrict the Company s ability to expand its facilities or require the Company to acquire additional costly pollution control equipment, incur other significant expenses or modify its manufacturing processes. The Company has incurred and will continue to incur capital expenditures and operating costs in complying with these laws and regulations. In addition, because the Company generates hazardous wastes during some of its manufacturing processes, the Company, along with any other entity that

Table of Contents

disposes or arranges for the disposal of the Company s wastes, may be subject to financial exposure for costs associated with any investigation and remediation of sites at which the Company has disposed or arranged for the disposal of hazardous wastes if those sites become contaminated, even if the Company fully complied with applicable environmental laws at the time of disposal. In the event that new contamination is discovered, the Company may become subject to additional requirements with respect to existing contamination or the Company s clean-up obligations.

The Company is also subject to numerous federal, state, local and foreign laws that regulate the manufacture, storage, distribution and labeling of many of the Company s products, including some of the Company s disinfecting, sanitizing and antimicrobial products. Some of these laws require the Company to have operating permits for the Company s production facilities, warehouse facilities and operations. Various federal, state, local and foreign laws and regulations also require the Company to register the Company s products and to comply with specified requirements with respect to those products. If the Company fails to comply with any of these laws and regulations, it may be liable for damages and the costs of remedial actions in excess of the Company s recorded liabilities, and may also be subject to fines, injunctions or criminal sanctions or to revocation, non-renewal or modification of the Company s operating permits and revocation of the Company s product registrations. Any such revocation, modification or non-renewal may require the Company to cease or limit the manufacture and sale of its products at one or more of the Company s facilities, which may limit or prevent the Company s ability to meet product demand or build new facilities and may have a material adverse effect on the Company s business, financial position, results of operations and cash flows. Any such revocation, non-renewal or modification may also result in an event of default under the indenture for the Company s notes or under the Company s credit facilities, which, if not cured or waived, may result in the acceleration of all the Company s indebtedness.

In addition to the costs of complying with environmental, health and safety requirements, the Company has incurred and may incur in the future costs defending against environmental litigation brought by government agencies and private parties. The Company may be a defendant in lawsuits brought by parties in the future alleging environmental damage, personal injury or property damage. A significant judgment against the Company could harm its business, financial position, results of operations and cash flows. Although the Company has insurance that may cover some of these potential losses, there is always uncertainty as to whether such insurance may be available to the Company based on case-specific factors and the specific provisions of the Company s insurance policies.

The potential cost to the Company relating to environmental, health and safety and product registration matters, including the cost of complying with the foregoing legislation and remediating contamination, is uncertain due to factors such as the unknown magnitude and type of possible contamination and clean-up costs, the complexity and evolving nature of laws and regulations relating to the environment, health and safety and product registration, including those outside of the U.S., and the timing, variable costs and effectiveness of clean-up and compliance methods. Environmental and product registration laws may also become more stringent over time, imposing greater compliance costs and increasing risks and penalties associated with any violation, as well as restricting or prohibiting the sale of existing or new products, which may also negatively impact the Company s operating results. Without limiting the foregoing, these laws or regulations may restrict or prohibit the use of non-renewable or carbon-based substances, or impose fees or penalties for the use of these substances. Accordingly, the Company may become subject to additional liabilities and increased operating costs in the future under these laws and regulations. The impact of any such changes, which are unknown at this time, may have a material adverse effect on the Company s business, financial position, results of operations and cash flows.

Other laws and regulations that apply to the Company may be changed to impose additional requirements beyond those that apply under current laws and regulations, and/or impose additional costs or have negative financial effects on the Company. Such changes, which are unknown at this time and beyond the Company s reasonable control, could have a material impact on the Company.

The Company s inability to estimate and maintain appropriate levels of recorded liabilities for existing and future contingencies may materially and adversely affect the Company s business, financial position, results of operations and cash flows.

The liabilities recorded by the Company for pending and threatened legal proceedings are estimates based on various assumptions. An adverse ruling or external forces, such as changes in the rate of inflation, the regulatory environment and other factors that could prove such assumptions to be no longer appropriate, may affect the accuracy of these estimates. Given the uncertainties inherent in such estimates, the Company s actual liabilities could differ significantly from the estimated amounts the Company records in its financial statements with respect to existing and future contingencies. If the Company s actual liability is higher than estimated or any new legal proceeding is initiated, it could materially and adversely affect the Company s business, financial position, results of operations and cash flows.

The Company has a significant amount of indebtedness and may incur additional indebtedness, or need to refinance existing indebtedness, in the future, which may adversely affect the Company s business, financial position, results of operations and cash flows.

The Company has a significant amount of indebtedness and may incur additional indebtedness in the future. As of December 31, 2013, the Company had $270.6 million of debt on its balance sheet. U.S. debt included $242.1 million in unsecured promissory notes with maturities extending from 2014 until 2025. In addition, to provide liquidity, the Company has a $125.0 million revolving credit facility.

The Company s foreign subsidiaries also maintain bank term loans and short-term bank lines of credit in their respective countries to meet working capital requirements as well as to fund capital expenditure programs and acquisitions. As of December 31, 2013, the Company s foreign subsidiaries aggregate outstanding debt totaled $28.5 million.

The Company s current indebtedness and any additional indebtedness incurred in the future may materially and adversely affect its business, financial position, results of operations and cash flows. For example, it could:

- require the Company to dedicate a substantial portion of cash flow from operations to pay principal and interest on the Company s debt, which would reduce funds

Table of Contents

available to fund future working capital, capital expenditures and other general operating requirements;

limit the Company s ability to borrow funds that may be needed to operate and expand its business;

limit the Company s flexibility in planning for or reacting to changes in the Company s business and the industries in which the Company operates;

increase the Company s vulnerability to general adverse economic and industry conditions or a downturn in the Company s business; and

place the Company at a competitive disadvantage compared to its competitors that have less debt.

The Company s loan agreements contain provisions, which, among others, require maintenance of certain financial ratios and place limitations on additional debt, investments and payment of dividends. Failure to comply with these loan agreements would require debt restructuring that could be materially adverse to the Company s financial position, results of operations and cash flows. Additionally, any future disruptions in the credit and financial markets may reduce the availability of debt financing or refinancing and increase the costs associated with such financing. If the Company is unable to secure financing on satisfactory terms, or at all, its business financial position, results of operations and cash flows may be materially and adversely affected.

Downturns in certain industries and general economic downturns may have an adverse effect on the Company s business, financial position, results of operations and cash flows.

Economic downturns may adversely affect users of some end products that are manufactured using the Company s products and the industries in which such end products are used. These users may reduce their volume of purchases of such end products during economic downturns, which would reduce demand for the Company s products. Additionally, uncertain conditions in the credit markets pose a risk to the overall economy that may impact consumer and customer demand of some of the Company s products, as well as the Company s ability to manage normal commercial relationships with its customers, suppliers and creditors. Some of the Company s customers may not be able to meet the terms of sale and suppliers may not be able to fully perform their contractual obligations due to tighter credit markets or a general slowdown in economic activity.

In the event that economic conditions worsen or result in a prolonged downturn or recession, the Company s business, financial position, results of operations and cash flows may be materially and adversely affected.

Table of Contents

The Company relies extensively on information technology (IT) systems to operate most aspects of its business. Interruption of, damage to or compromise of Company IT systems could have an adverse effect on the Company s business, financial position, results of operations and cash flows.

The Company relies on IT systems for most areas of operations, including production, supply chain, research and development, finance, human resource, regulatory and various other functions. The Company s ability to effectively manage its business depends on the security, reliability and adequacy of these systems. IT system failures due to network disruptions or security breaches (e.g., cyber attacks) could impact production activities, impede shipment of products, cause delays or cancellations of customer orders, hamper the processing of transactions or reporting of financial results or make sensitive, private or proprietary information public. While the Company has a comprehensive program for continuously reviewing, maintaining, testing and upgrading its IT systems and security, there can be no assurance that such efforts will prevent breakdowns or breaches in Company systems that could adversely affect the Company s business, financial position, results of operations and cash flows.

Various liability claims could materially and adversely affect the Company s financial position, operating results and cash flows.

The Company may be required to pay for losses or injuries purportedly caused by its products. The Company faces an inherent exposure to various types of claims including general liability, product liability, product recall, toxic tort and environmental (claims), among others, if its products, or the end products that are manufactured with the Company s products, result in property damage, injury or death. In addition, because the Company conducts business in multiple jurisdictions, the Company also faces an inherent exposure to other general claims based on its operations in those jurisdictions and the laws of those jurisdictions, including but not limited to claims arising from its relationship with employees, distributors, agents and customers, and other parties with whom it has a business relationship, directly or indirectly. Many of these claims may be made against the Company even if there is no evidence of a loss from that claim, and these claims may be either made by individual entities, or potentially a group of plaintiffs in a class action. Defending these claims could result in significant legal expenses relating to defense costs and/or damage awards and diversion of management s time and the Company s resources. Any claim brought against the Company, net of potential insurance recoveries, could materially and adversely affect the Company s business financial position, results of operations and cash flows.

The Company s forecasts and other forward-looking statements are based on a variety of assumptions and estimates that are subject to significant uncertainties. The Company s performance may not be consistent with these forecasts or forward-looking statements.

From time to time in press releases and other documents filed with the SEC, the Company publishes forecasts or other forward-looking statements regarding its future results, including estimated revenues, net earnings and other operating and financial metrics.

Table of Contents

Any forecast or forward-looking statement related to the Company s future performance reflects various assumptions and estimates, which are subject to significant uncertainties, and the achievement of any forecast or forward-looking statement depends on numerous risks and other factors, including those described in this Annual Report on Form 10-K, many of which are beyond the Company s control. If these assumptions and estimates prove to be incorrect, or any of the risks or other factors occur, then the Company s performance may not be consistent with these forecasts or forward-looking statements.

You are cautioned not to rely solely on such forward-looking statements, but instead are encouraged to utilize the entire mix of publicly available historical and forward-looking information, as well as other available information affecting the Company, the Company s services and the Company s industry, when evaluating the Company s forecasts and other forward-looking statements relating to the Company s operations and financial performance.

Table of Contents

Item 1B. Unresolved Staff Comments

None

Item 2. Properties

The following are the Company s principal plants and other important physical properties. Unless otherwise noted, the listed properties are owned by the Company. Management believes that the facilities are suitable and adequate for the Company s current operations.

	Name of Facility	Location	Site Size	Product
1.	Millsdale	Millsdale (Joliet), Illinois	492 acres	Surfactants/Polymers
2.	Fieldsboro	Fieldsboro, New Jersey	45 acres	Surfactants
3.	Anaheim	Anaheim, California	8 acres	Surfactants
4.	Winder	Winder, Georgia	202 acres	Surfactants
5.	Maywood	Maywood, New Jersey	19 acres	Surfactants / Specialty Products
6.	Columbus	Columbus, Georgia	29.8 acres	Polymers
7.	Stepan France	Voreppe, France	20 acres	Surfactants
8.	Stepan Mexico	Matamoros, Mexico	13 acres	Surfactants
9.	Stepan Germany	Wesseling, Germany	12 acres	Surfactants/Polymers
10.	Stepan UK	Stalybridge, United Kingdom	11 acres	Surfactants
11.	Stepan Colombia	Manizales, Colombia	5 acres	Surfactants
12.	Stepan Canada	Longford Mills, Canada	70 acres (leased)	Surfactants
13.	Stepan China	Nanjing, China	4 acres (leased)	Polymers (no longer manufacturing at this site)
14.	Stepan Brazil	Vespasiano, Minas Gerais, Brazil	27 acres (capital lease)	Surfactants
15.	Stepan Philippines	Bauan, Batangas, Philippines	9 acres (leased)	Surfactants
16.	Stepan Poland	Brzeg Dolny, Poland	4 acres (perpetual use right)	Polymers
17.	Stepan Asia	Jurong Island, Singapore	8 acres (leased)	Surfactants
18.	Company Headquarters and Central Research Laboratories	Northfield,	8 acres	N/A

		Illinois		
19.	Company Corporate Supply Chain, Human Resources, Legal and Finance Functions	Northbrook, Illinois	3.25 acres	N/A

Item 3. Legal Proceedings

There are a variety of legal proceedings pending or threatened against the Company that occur in the normal course of the Company s business, the majority of which relate to environmental matters. 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 relative to or has been named by the government as a potentially responsible party at a number of 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 these sites. For most of these sites, the involvement of the Company is expected to be minimal. The most significant sites are described below:

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 Company submitted comments to USEPA on the Proposed Plan in December 2013. Those comments raised significant issues with both the Proposed Plan s remedy selections and cost estimates. As a result, the Proposed Plan has had no impact on the Company s recorded liability at this time. 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.

Table of Contents

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 third 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.

Other Matters

The Company has been named as a de minimis PRP at other sites, and as such the Company believes that a resolution of its liability will not have a material impact on the financial position, results of operations or cash flows of the Company.

Item 4. Mine Safety Disclosures

Not Applicable.

Table of Contents

PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

All 2012 share and per share data in Item 5 have been retroactively adjusted to reflect the two-for-one common stock split that was effective on December 14, 2012.

(a) The Company s common stock is listed and traded on the New York Stock Exchange. See table below for New York Stock Exchange quarterly market price information.

Quarterly Stock Data

	Stock Price Range			
	2013		*2012*	
Quarter	**High**	***Low***	*High*	*Low*
First	**$ 64.99**	**$ 55.43**	$ 46.00	$ 38.05
Second	**$ 63.27**	**$ 52.34**	$ 47.25	$ 41.35
Third	**$ 59.98**	**$ 55.51**	$ 50.43	$ 42.72
Fourth	**$ 67.20**	**$ 56.06**	$ 55.90	$ 44.89
Year	**$ 67.20**	**$ 52.34**	$ 55.90	$ 38.05

On June 12, 2013, the Company announced that on August 9, 2013 (redemption date) it would redeem any remaining outstanding shares of its $5\,{}^{1}/_{2}$ 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. In accordance with the Certificate of Designation, Preferences and Rights of the $5\,{}^{1}/_{2}$% Convertible Preferred Stock (Preferred Shareholders Agreement), the Company redeemed 835 shares of unconverted 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 (see also Note 11, Stockholders Equity, of the consolidated financial statements).

On February 19, 2013, the Board of Directors of Stepan Company authorized the Company to repurchase up to 1,000,000 shares of its outstanding common stock. This repurchase authorization replaced the previous authorization of February 11, 2009, and the remaining unutilized 2009 repurchase authorization of 170,542 shares was cancelled. During 2013, 41,688 shares of Company common stock were purchased in the open market, 1,562 shares of common stock were received in lieu of cash from employees exercising stock options and 17,345 shares of common stock were received to settle employees minimum statutory withholding taxes related to performance stock awards and deferred compensation distribution. The purchased and received shares were recorded as treasury stock in the Company s balance sheet. At December 31, 2013, 958,312 shares remained available for repurchase under the February 19, 2013, authorization. The timing and amount of the repurchases are determined by the Company s management based on its evaluation of market conditions and share price. Shares will be repurchased with cash in open market or private transactions in accordance with applicable securities and stock exchange rules.

In October 2012, the Board of Directors declared a two-for-one stock split on the Company s common stock in the form of a 100 percent stock dividend, which was paid on December 14, 2012.

(b) On January 31, 2014, there were 1,543 holders of record of common stock of the Company.

(c) Below is a summary by month of share purchases by the Company during the fourth quarter of 2013:

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs
October				
November	1,562 [(a)]	$ 58.80		
December				

(a) Represents shares tendered in lieu of cash for stock option exercises. The shares tendered were held by the individual exercising the options for more than six months.

(d) See table below for quarterly dividend information.

Dividends Declared Per Common Share

Quarter	*2013*	*2012*
First	**$ 0.16**	$ 0.14
Second	**$ 0.16**	$ 0.14
Third	**$ 0.16**	$ 0.14
Fourth	**$ 0.17**	$ 0.16
Year	**$ 0.65**	$ 0.58

The Company has material debt agreements that restrict the payment of dividends. See the Liquidity and Financial Condition section of Part II, Item 7, Management s Discussion and Analysis, for a description of the restrictions. See also Note 7, Debt, of the consolidated financial statements (Item 8 of this Form 10-K) for the amount of retained earnings available for dividend distribution at December 31, 2013.

Table of Contents

(e) Stock Performance Graph

The following stock performance graph compares the yearly change since December 31, 2008, in cumulative return on the common stock of the Company on a dividend reinvested basis to the Dow Jones Chemical Industry Index and the Russell 2000 Index. The Dow Jones Chemical Industry Index is a market-capitalization weighted grouping of 32 chemical companies, including major manufacturers of both basic and specialty products. The Company is not included in the Dow Jones Chemical Industry Index. The Russell 2000 Index is a market-capitalization weighted grouping of 2,000 small to medium sized companies in a broad range of industries. The Company has been included in the Russell 2000 Index since 1992. The graph assumes $100 was invested on December 31, 2008, and shows the cumulative total return as of each December 31 thereafter.

Table of Contents

Item 6. Selected Financial Data

(In thousands, except per share data)

For the Year	***2013***	*2012*	*2011*	*2010*	*2009*
Net Sales	**$ 1,880,786**	$ 1,803,737	$ 1,843,092	$ 1,431,122	$ 1,276,382
Operating Income	**109,153**	128,716	118,456	107,897	104,888
Percent of Net Sales	**5.8%**	7.1%	6.4%	7.5%	8.2%
Income Before Provision for Income Taxes	**95,630**	115,722	104,894	101,479	97,131
Percent of Net Sales	**5.1%**	6.4%	5.7%	7.1%	7.6%
Provision for Income Taxes	**23,293**	36,035	32,292	35,888	34,028
Net Income Attributable to Stepan Company	**72,828**	79,396	71,976	65,427	63,049
Per Diluted Share [(a)]	**3.18**	3.49	3.21	2.95	2.92
Percent of Net Sales	**3.9%**	4.4%	3.9%	4.6%	4.9%
Percent to Total Stepan Company Stockholders Equity[(b)]	**14.1%**	18.0%	19.2%	20.5%	25.3%
Cash Dividends Paid	**14,474**	12,757	11,513	10,570	9,557
Per Common Share [(a)]	**0.6500**	0.5800	0.5300	0.4900	0.4500
Depreciation and Amortization	**56,400**	51,294	47,099	40,351	37,171
Capital Expenditures	**92,865**	83,159	83,166	73,748	42,631
Weighted-average Common Shares Outstanding (Diluted) [(a)]	**22,924**	22,730	22,440	22,180	21,592
As of Year End					
Working Capital	**$339,557**	$275,911	$246,516	$222,199	$186,297
Current Ratio	**2.3**	2.1	2.1	2.1	2.1
Property, Plant and Equipment, net	**494,042**	422,022	383,983	353,585	248,618
Total Assets	**1,167,202**	985,478	901,118	811,431	634,203
Long-term Debt Obligations, Less Current Maturities	**235,246**	149,564	164,967	159,963	93,911
Total Stepan Company Stockholders Equity	**552,286**	478,985	401,211	349,491	289,285

(a) Comparative historical data reflects the two-for-one common stock split that was effective December 14, 2012.
(b) Based on average equity.

21

Table of Contents

Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

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 this Annual Report on Form 10-K.

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 70 percent of consolidated net sales in 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. Sales and related profits of the Company s surfactants to enhanced oil recovery customers are included in surfactants segment results.

Polymers Polymers, which accounted for 26 percent of consolidated net sales in 2013, includes 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 coatings, adhesives, sealants and elastomers (collectively CASE products) and flexible foams. 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

Table of Contents

Columbus, Georgia, site (see the Acquisition section that follows 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 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 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 $64.0 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, which included both liquid and powdered resins, 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 $68.2 million of cash, of which $61.1 million was paid at closing with $7.1 million, 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 financial effect of the new business was immaterial, although slightly accretive, to Company earnings for 2013. See Note 2 of the consolidated financial statements for further details regarding the acquisition.

Table of Contents

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:

(In millions)	Income (Expense) For the Year Ended December 31		
	2013	2012	Change
Deferred Compensation (Administrative expense)	($9.5)	($10.2)	$0.7[1]
Investment Income (Other, net)	1.0	0.1	0.9
Realized/Unrealized Gains (Losses) on Investments (Other, net)	2.5	1.3	1.2
Pretax Income Effect	($6.0)	($8.8)	$2.8

(In millions)	Income (Expense) For the Year Ended December 31		
	2012	2011	Change
Deferred Compensation (Administrative expense)	($10.2)	($1.5)	$(8.7)[1]
Investment Income (Other, net)	0.1	0.1	
Realized/Unrealized Gains (Losses) on Investments (Other, net)	1.3	(0.1)	1.4
Pretax Income Effect	($8.8)	($1.5)	$(7.3)

(1) See the applicable Corporate Expenses section of this MD&A for details regarding the period-to-period changes in deferred compensation.

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 year-to-year comparisons of financial statement items (i.e., because foreign exchange rates fluctuate, similar year-to-year local currency results for a foreign subsidiary

24

Table of Contents

may translate into different U.S. dollar results). The following tables present the effects that foreign currency translation had on the year-over-year changes in consolidated net sales and various income line items for 2013 compared to 2012 and 2012 compared to 2011:

(In millions)	Year Ended December 31 2013	2012	Increase (Decrease)	Increase Due to Foreign Translation
Net Sales	$ 1,880.8	$ 1,803.7	$ 77.1	$ 2.3
Gross Profit	281.7	291.6	(9.9)	
Operating Income	109.2	128.7	(19.5)	
Pretax Income	95.6	115.7	(20.1)	0.2

(In millions)	Year Ended December 31 2012	2011	Increase (Decrease)	Decrease Due to Foreign Translation
Net Sales	$ 1,803.7	$ 1,843.1	$ (39.4)	$ (39.6)
Gross Profit	291.6	255.6	36.0	(5.2)
Operating Income	128.7	118.5	10.2	(2.7)
Pretax Income	115.7	104.9	10.8	(2.6)

RESULTS OF OPERATIONS

2013 Compared with 2012

Summary

Net income attributable to the Company for 2013 declined eight percent to $72.8 million, or $3.18 per diluted share, compared to $79.4 million, or $3.49 per diluted share, for 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 2013 follows the summary.

Consolidated net sales increased $77.0 million, or four percent, year over year due to a seven percent improvement in sales volume and to the favorable effects of foreign currency translation, which accounted for $118.6 million and $2.3 million, respectively, of the net sales increase. Sales volumes for all three segments improved six percent for surfactants, eight percent for polymers and two percent for specialty products. A decline in average selling prices had a $43.9 million unfavorable impact on the year-over-year net sales change. Decreased raw material costs and a less favorable mix of sales for surfactants led to the drop in average selling prices.

Operating income for 2013 declined $19.6 million, or 15 percent, from operating income for 2012. Gross profit decreased $9.9 million, or three 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. The higher polymers

25

Table of Contents

gross profit was largely due to greater sales volume for European and North American operations. In addition, 2013 European polymer profits benefited from insurance recovery income that was $2.5 million greater than that for 2012. Gross profit for surfactants was negatively impacted by lower margins that more than offset the effect of higher sales volume. Included in 2013 surfactants gross profit were approximately $9.0 million of expenses resulting from the consumption of higher cost raw material inventory built to support the Company s Singapore plant start-up, contractual timing differences between changes in raw material costs and selling prices and non-recurring costs to secure a strategic raw material for specialty surfactant growth. 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 $9.7 million, or six 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 $0.1 million, or less than one percent, year over year. The only significant year-over-year variance was a $1.6 million reduction in U.S. fringe benefit expenses largely due to declines in short and long-term incentive expenses. Increases in a number of small expense items offset the decrease in U.S. benefit expense.

Administrative expenses increased $7.5 million, or twelve percent, year over year. Much of the increase reflected the Company s continued investment in growth and innovation initiatives. Increases in corporate and other Company entity legal (including intellectual property), acquisition (actual and exploratory) and salary expenses accounted for $2.4 million, $1.0 million and $0.9 million, respectively, of the year-over-year change in corporate expenses. In addition, 2013 expenses included a $0.7 million charge for estimated dismantling costs for the manufacturing site in Nanjing, China. Other contributors to the increase in consolidated administrative expenses included hardware and software maintenance ($0.5 million), hiring ($0.3 million) and temporary help ($0.3 million). The remaining year-over-year variance is attributable to the accumulation of small increases across the Company s global organization.

The above increases were partially offset by a $0.7 million year-over-year decline in deferred compensation expense. The decline reflected a year-over-year increase in the value of Company stock that was smaller in 2013 than in 2012. See the Overview and Corporate Expenses sections of this MD&A for further details.

Research, development and technical service (R&D) expenses were up $1.1 million, or two percent, year over year. Most of the increase was attributable to higher personnel, outside contract service and consulting expenses required to pursue the Company s growth and innovation opportunities. Lower product registration costs under Europe s REACH (Registration, Evaluation, Authorization and Restriction of Chemicals) regulation favorably affected the year-over-year change in R&D expenses by $0.6 million.

Table of Contents

Business Restructuring   In the fourth quarter of 2013, the Company approved a plan to consolidate a portion of its North American surfactants manufacturing operations (part of the surfactants reportable segment) to reduce future costs and optimize asset utilization. The Company will shut down sulfonation production at its Canadian manufacturing site, which will result in the elimination of an estimated 20 North American positions. Production of affected products currently manufactured in Canada will be moved to U.S. plants. The restructuring effort is expected to be completed in the third quarter of 2014.

As a result of the approved plan, the Company recognized $1.0 million of one-time severance expenses in the fourth quarter of 2013. Most of the severance payments are expected to be made in the third quarter of 2014.

It should be noted that in addition to the restructuring costs, the Company reduced the useful lives of the manufacturing assets in the affected areas of the Canada plant. As a result, the Company recognized $0.3 million of additional depreciation expense in the fourth quarter of 2013. The expense was included in the cost of sales line of the consolidated statement of income. The change in the useful lives of the assets will add about $1.8 million of depreciation expense in the first half of 2014.

The loss from the Company s 50-percent equity joint venture (TIORCO) increased $0.6 million year over year primarily due to lower commission income.

Net interest expense in 2013 increased $0.8 million over net interest expense in 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 matures 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 $2.2 million of income for 2013 compared to $1.3 million of income for 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 $2.1 million year over year. Foreign exchange losses were $1.5 million for 2013 compared to $0.3 million for 2012.

The effective tax rate was 24.4 percent in 2013 compared to 31.1 percent in 2012. The decrease was primarily attributable to a favorable IRS ruling published in the fourth quarter of 2013 that allowed the Company to exclude certain biodiesel excise tax credits from income retroactive to January 1, 2010 (this ruling was a major factor for the $0.2 million income tax provision benefit reported by the Company in the fourth quarter of 2013). The decrease was also attributable to 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. Also contributing to the effective tax rate decline was a greater percentage of consolidated income being generated outside the U.S. where the effective tax rates are lower. See Note 10 to the consolidated financial statements for a reconciliation of the statutory U.S. federal income tax rate to the effective tax rate.

Table of Contents

Segment Results

(In thousands)	Surfactants	Polymers	Specialty Products	Segment Results	Business Restructuring	Corporate	Total
For the year ended December 31, 2013							
Net sales	$ 1,317,164	$ 483,361	$ 80,261	$ 1,880,786			$ 1,880,786
Operating income	100,201	54,536	10,902	165,639	(1,040)	(55,446)	109,153
For the year ended December 31, 2012							
Net sales	$ 1,305,800	$ 423,959	$ 73,978	$ 1,803,737			$ 1,803,737
Operating income	118,591	48,130	12,242	178,963		(50,247)	128,716

Surfactants

Surfactants net sales for 2013 increased $11.4 million, or one percent, over net sales for 2012. Sales volume increased by six percent, which favorably affected the year-over-year net sales change by $83.2 million. All regions reported sales volume improvements. A decline in average selling prices and the unfavorable effects of foreign currency translation offset the impact of sales volume by $69.0 million and $2.8 million, respectively. The decrease in average selling prices was largely due to reduced raw material costs. A year-over-year comparison of net sales by region follows:

(In thousands)	For the Year Ended December 31, 2013	For the Year Ended December 31, 2012	Increase (Decrease)	Percent Change
North America	$ 802,568	$ 810,988	$ (8,420)	-1
Europe	287,394	286,071	1,323	
Latin America	160,426	156,509	3,917	+3
Asia	66,776	52,232	14,544	+28
Total Surfactants Segment	$ 1,317,164	$ 1,305,800	$ 11,364	+1

Net sales for North American operations declined one percent. Sales volume increased three percent, which favorably affected the year-over-year change in net sales by $21.9 million. The increase in sales volume reflected greater sales of functional surfactants used in agricultural and biodiesel applications and increased consumer product sales. Sales volume of oil field chemicals declined between years. Average selling prices declined three percent, which had a $28.6 million negative effect on the year-over-year net sales change. Lower raw material costs and the effects of customer contract selling price lags led to the decline in average selling prices. The effects of foreign currency translation had a $1.7 million unfavorable effect on the net sales change.

Net sales for European operations increased less than one percent between years. Sales volume increased six percent, which had a $15.8 million favorable effect on the year-over-year net sales change. Increased sales of Company products used in personal care, HI&I (household, institution and industrial) and agricultural chemical applications drove the sales volume improvement. Most of the improvement came from additional business from existing customers. A six percent decline in average selling prices had a negative $18.8 million effect on the year-over-year net sales change. Lower raw material costs and price competition led to the reduction in selling prices. The effects of foreign currency translation had a $4.3 million positive effect on the net sales change.

Net sales for Latin American operations increased three percent as a result of a 12 percent increase in sales volume partially offset by a five percent decline in average selling prices and a four percent negative effect of foreign currency translation. The increased sales volume had an $18.0 million positive effect on the year-over-year net sales change, while the decreased selling prices and impact of foreign currency translation had negative effects of $9.0 million and $5.1 million, respectively. Sales volume for all three Latin American locations improved between years, with most of the increase derived from Brazil, where the Company has focused on expanding its surfactants franchise. The decrease in average selling prices reflected declines in raw material costs.

Net sales for Asia operations increased 28 percent due to a 33 percent increase in sales volume, reflecting sales from the Singapore subsidiary that was not commercially operational until the fourth quarter of 2012.

Surfactants operating income for 2013 declined $18.4 million, or 16 percent, from operating income for 2012. Gross profit fell $17.7 million, or nine percent. Included in 2013 surfactants gross profit were approximately $9.0 million of expenses resulting from the consumption of higher cost raw material inventory built to support the Company s Singapore plant start-up, contractual timing differences between changes in raw material costs and selling prices and non-recurring costs to secure a strategic raw material for specialty surfactant growth. The effects of foreign currency translation contributed $1.0 million to the gross profit decline. Operating expenses increased $0.7 million, or one percent. Year-over-year comparisons of gross profit by region and total segment operating expenses and operating income follow:

(In thousands)	For the Year Ended			
	December 31, 2013	December 31, 2012	Increase (Decrease)	Percent Change
Gross Profit				
North America	$ 128,643	$ 155,891	$ (27,248)	-17
Europe	24,928	24,759	169	+1
Latin America	22,114	20,381	1,733	+9
Asia	10,021	2,339	7,682	+328
Total Surfactants Segment	$ 185,706	$ 203,370	$ (17,664)	-9
Operating Expenses	85,505	84,779	726	+1
Operating Income	$ 100,201	$ 118,591	$ (18,390)	-16

Table of Contents

North American gross profit declined 17 percent year over year due to reduced margins that more than offset the effect of the three percent improvement in sales volume. Factors that contributed to the lower sales margins included customer contract selling price lags (which unfavorably impacted selling margins in 2013 while favorably impacting margins in 2012), the consumption of high priced methyl ester inventories (built up in the prior fourth quarter to support the Singapore start-up) and non-recurring costs to secure a strategic raw material for specialty surfactant growth. In addition, manufacturing expenses increased $4.2 million (3 percent) between years primarily due to higher maintenance and depreciation costs. Fourth quarter 2013 gross profit declined $13.1 million from gross profit for the fourth quarter of 2012 despite a six percent increase in sales volume. The decline in quarter-over-quarter gross profit was due to the factors cited above and also due to the fact that costs for a number of key raw materials began rising in the fourth quarter, which had a further negative effect on margins. The Company announced selling price increases effective mid-January 2014 to recapture these higher costs.

Gross profit for European operations increased one percent year over year. The effect of the six percent sales volume increase was largely offset by a less favorable mix of sales. In addition, competitive pressures led to some selling price reductions.

Gross profit for Latin American operations increased nine percent primarily due to the 12 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. The effects of foreign currency translation had a $1.2 million unfavorable effect on the year-over-year change in gross profit.

Asia operations gross profit improvement was principally due to the Singapore subsidiary, which was not commercially operational until the fourth quarter of 2012.

Operating expenses for the surfactants segment were up $0.7 million, or one percent, year over year. Administrative expenses increased $1.5 million, and R&D and marketing expenses declined $0.6 million and $0.2 million, respectively. Approximately $1.0 million of the increase in administrative expenses reflected higher costs necessary to support the Company s growth initiatives in Asia and Latin America. The decline in R&D expenses was attributable to a decrease in product registration expenses ($0.6 million) under Europe s REACH initiative.

Polymers

Polymers net sales for 2013 increased $59.4 million, or 14 percent, over net sales for 2012. An eight percent increase in sales volume, higher average selling prices and the favorable effects of foreign currency translation accounted for $33.6 million, $21.2 million and $4.6 million, respectively, of the net sales improvement. The acquired BMS North American polyester resins business contributed $31.9 million to 2013 net sales. A year-over-year comparison of net sales by region is displayed below:

(In thousands)	For the Year Ended			
	December 31, 2013	December 31, 2012	Increase	Percent Change
North America	$ 294,421	$ 262,376	$ 32,045	+12
Europe	161,262	135,198	26,064	+19
Asia and Other	27,678	26,385	1,293	+5
Total Polymers Segment	$ 483,361	$ 423,959	$ 59,402	+14

Net sales for North American operations increased 12 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 $31.9 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 three percent. Phthalic anhydride volume was down six percent due primarily to continued weak demand from polyester resin customers. Sales volume for rigid polyol products in insulation applications was down one percent. 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 three percent year over year due to higher average raw material costs and a more favorable product mix of sales.

Net sales for European operations increased 19 percent due to a 16 percent improvement in sales volume and the favorable effects of foreign currency translation, which accounted for $22.0 million and $4.1 million, respectively, of the growth in net sales. Increased business from a number of major polyol customers, due in part to increased sales of polyols for metal panel applications, and the addition of a new customer 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 improved five percent between years due to a more favorable customer sales mix and to a $0.5 million positive foreign currency translation effect. Sales volume was down one percent year over year.

Polymer operating income for 2013 increased $6.4 million, or 13 percent, over operating income for 2012. Gross profit improved $9.0 million due to year-over-year improvement for European and North American operations. In addition, current year profits benefited from insurance recovery income that was $2.5 million greater in 2013 than in 2012. The insurance recoveries in both years were for lost business resulting from a 2011 fire that damaged polyol equipment at the Germany site. Operating expenses increased $2.6 million, or 11 percent.

Table of Contents

Year-over-year comparisons of gross profit by region and total segment operating expenses and operating income follow:

(In thousands)	For the Year Ended December 31, 2013	December 31, 2012	Increase (Decrease)	Percent Change
Gross Profit				
North America	$ 53,554	$ 50,006	$ 3,548	+7
Europe	27,380	18,688	8,692	+47
Asia and Other	(17)	3,207	(3,224)	-101
Total Polymers Segment	$ 80,917	$ 71,901	$ 9,016	+13
Operating Expenses	26,381	23,771	2,610	+11
Operating Income	$ 54,536	$ 48,130	$ 6,406	+13

Gross profit for North American operations increased seven percent between years mainly due to higher margins and to the contribution derived from the BMS business acquisition. The higher margins resulted from a combination of selling price increases and a more favorable mix of sales. The year-over-year improvement in gross profit for North American operations was tempered by a large 2012 sale of a urethane systems product used in a new aircraft carrier. There were no such sales in 2013.

The 47 percent increase in gross profit for European operations was primarily driven by the previously mentioned 16 percent improvement in sales volume and the $2.5 million year-over-year increase in insurance recovery income. Increased unit margins and a $0.9 million favorable effect of foreign currency also contributed.

The decline in gross profit for Asia and Other operations was due to reduced selling margins, higher expenses and the one percent decrease in sales volume. As a result of ceasing manufacturing at the plant site in Nanjing, China, 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. As noted in previous filings, government officials in Nanjing, China, informed the Company that its manufacturing facility needed to be relocated. In 2012, the Company purchased land use rights in the Nanjing Chemical Industrial Park as a potential site on which to construct a new manufacturing plant. Management continues to review the scope and cost of a building project, while concurrently negotiating with the local government for compensation for the move.

Polymer operating expenses increased $2.6 million, or 11 percent, year over year. Higher R&D ($0.9 million) and selling ($0.3 million) expenses, a $0.7 million charge for estimated dismantling costs for the manufacturing site in Nanjing, China, and the unfavorable effects of foreign currency translation ($0.3 million) accounted for most of the operating expense increase. North American operations accounted for $0.8 million of the increase in R&D expenses. Approximately $0.2 million of the increase was attributable to resources needed to support the acquired BMS business. The remainder of the increase in North American R&D expenses was due to planned additional spending for polyol and CASE research projects. European operations accounted for the rise in selling expenses.

32

Table of Contents

Specialty Products

Net sales for 2013 increased $6.3 million, or eight percent, over net sales for the same period of 2012. Operating income declined $1.3 million due to higher raw material costs, increased manufacturing and operating expenses and competitive pricing pressures, especially for the Company s medium-chain triglyceride products used in food ingredient applications.

Corporate Expenses

Corporate expenses increased $5.2 million to $55.4 million for 2013 from $50.2 million for 2012. In large part, the increase in corporate expenses reflected the Company s continued investment in its growth and innovation initiatives. Increases in legal, acquisition (actual and exploratory) and salary expenses accounted for $1.6 million, $1.0 million and $0.9 million, respectively, of the year-over-year change in corporate expenses. In addition, statutory profit sharing expense in France was up $1.6 million, and corporate computer hardware and software expenses were up $0.5 million. The increase in statutory profit sharing expense resulted from the transfer of ownership of the Company s European polymer intangibles from its France subsidiary to its Poland subsidiary.

A $0.7 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 market price of Company stock increased $10.09 per share in 2013 compared to $15.46 per share in 2012. Higher year-over-year mutual fund investment earnings partially offset the impact of the change in Company common stock values. The following table presents the year-end per share Company common stock prices used in the computation of deferred compensation expense:

	December 31		
	2013	2012	2011
Company Stock Price	$ 65.63	$ 55.54	$ 40.08

2012 Compared with 2011

Summary

Net income attributable to the Company for 2012 increased 10 percent to $79.4 million, or $3.49 per diluted share, compared to $72.0 million, or $3.21 per diluted share, for 2011. 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 results for 2012 compared to 2011 follows the summary.

Consolidated net sales declined $39.4 million, or two percent, year over year. Lower average selling prices and the unfavorable impact of foreign currency translation accounted for $39.7 million and $39.6 million, respectively, of the decrease. A two percent increase in sales volume offset the effects of lower prices and foreign currency translation by $39.9 million. Decreased average raw material costs for surfactants drove the decline in average selling prices. Weaker foreign currencies against the U.S. dollar for most countries in which

Table of Contents

the Company transacts business caused the unfavorable currency translation impact. Sales volume improved for the surfactants and polymers segments, but was down for specialty products.

Operating income for 2012 improved $10.3 million, or nine percent, over operating income reported for 2011. Gross profit increased $36.0 million, or 14 percent, due to higher unit profit margins and sales volumes. In addition, polymers gross profit benefited from a large sale of urethane systems used to insulate an aircraft carrier. All three segments contributed to the gross profit improvement. The effects of foreign currency translation reduced the year-over-year gross profit and operating income increases by $5.2 million and $2.7 million, respectively.

Operating expenses increased $25.7 million, or 19 percent, year over year. The following summarizes the year-over-year changes in the individual income statement line items that comprise the Company s operating expenses:

Administrative expenses increased $13.2 million, or 26 percent, largely due to an $8.7 million increase in deferred compensation expense. An increase in the value of Company common stock, to which a large part of the Company s deferred compensation obligation is tied, led to the higher year-over-year deferred compensation expense. See the Overview and Corporate Expenses sections of this management discussion and analysis for further details. Legal and environmental expenses and patent filing costs accounted for $1.8 million and $0.8 million, respectively, of the year-over-year administrative expense increase. Increased costs to protect intellectual property related to the Company s global innovation and growth activities led to the higher patent filing and legal expenses. Revised estimates for remediation costs at three of the Company s environmental sites contributed about $0.7 million to the higher legal and environmental expenses. In addition to the foregoing, corporate fringe benefit (which includes incentive pay) and salary expenses increased $0.8 million and $0.7 million, respectively, between 2012 and 2011. The increase in fringe benefits was driven by higher performance-based bonus and profit sharing expenses that reflected the year-over-year improvement in Company earnings. Additional staffing to support the Company s growth, promotions and normal pay raises caused the increase in salary expense. The effects of foreign currency translation reduced the year-over-year expense change by $0.8 million.

Selling expenses increased $7.3 million, or 16 percent, year over year. Approximately $1.7 million of the increase was due to added expense incurred for the Lipid Nutrition business, which was acquired in June 2011 (i.e., 12 months of expense in 2012 compared to six months of expense in 2011). North American fringe benefit and salary expenses increased $1.7 million and $1.5 million, respectively. The increased fringe benefits included higher bonus and profit sharing expenses, and the increased salary expenses reflected additional staffing and annual merit increases. Selling expenses in Latin America were $1.3 million higher due mainly to increased personnel expenses resulting from higher staffing levels to support the Company s growth initiatives in Brazil. Total bad debt expense increased $1.1 million primarily due to favorable reserve adjustments made in 2011. The effects of foreign currency translation reduced the year-over-year selling expense change by $1.3 million.

Research, development and technical service expenses increased $5.2 million, or 13 percent, year over year. Higher North American salary and fringe benefit expenses accounted for $1.3 million and $1.2 million of the increase, respectively. Expenses for European operations were up $1.7 million between 2012 and 2011 mainly due to a $0.8 million increase in costs for registering Company products under Europe s REACH (Registration, Evaluation, Authorization and Restriction of Chemical Substances) initiative and to a $0.7 million increase in salary and fringe benefit expenses. Lipid Nutrition and Singapore each added $0.4 million of additional research and development expenses (primarily personnel costs), respectively, in 2012. The effects of foreign currency translation reduced the year-over-year research, development and technical service expense increase by $0.4 million.

Interest expense, net, increased $0.5 million, or six percent, between years. Higher average borrowing levels led to the increase. In the fourth quarter of 2011, the Company secured $65 million of additional long-term notes to take advantage of low interest rates and to support global growth initiatives.

The loss from the Company s 50-percent equity joint venture (TIORCO) increased $1.1 million year over year primarily due to higher operating expenses and lower commission and technical service income.

Other, net was $1.3 million of income for 2012 compared to $0.9 million of expense for 2011. Investment activity for the Company s deferred compensation and supplemental defined contribution mutual fund assets resulted in income of $1.6 million for 2012 compared to expense of $0.1 million for 2011. In addition, foreign exchange losses for 2012 totaled $0.3 million compared to $0.8 million for 2011.

The effective tax rate was 31.1 percent in 2012 compared to 30.8 percent in 2011. The increase was primarily attributable to the expiration of the U.S. research and development tax credit which was partially offset by an overall lower state effective tax rate.

Segment Results

(In thousands)	Surfactants	Polymers	Specialty Products	Segment Results	Corporate	Total
For the year ended December 31, 2012						
Net sales	$ 1,305,800	$ 423,959	$ 73,978	$ 1,803,737		$ 1,803,737
Operating income	118,591	48,130	12,242	178,963	(50,247)	128,716
For the year ended December 31, 2011						
Net sales	$ 1,361,956	$ 421,515	$ 59,621	$ 1,843,092		$ 1,843,092

Operating income	100,811	40,909	13,307	155,027	(36,571)	118,456

35

Table of Contents

Surfactants

Surfactants net sales for 2012 declined $56.2 million, or four percent, from net sales for 2011. Lower average selling prices, primarily due to decreased raw material costs, and the effects of foreign currency translation accounted for $57.2 million and $28.1 million, respectively, of the decrease. Sales volume grew by two percent, which increased net sales by $29.1 million. All regions contributed to the sales volume improvement. A year-over-year comparison of net sales by region follows:

(In thousands)	For the Year Ended December 31, 2012	December 31, 2011	Increase (Decrease)	Percent Change
North America	$ 810,988	$ 839,940	$ (28,952)	-3
Europe	286,071	317,629	(31,558)	-10
Latin America	156,509	147,614	8,895	+6
Asia	52,232	56,773	(4,541)	-8
Total Surfactants Segment	$ 1,305,800	$ 1,361,956	$ (56,156)	-4

Net sales for North American operations decreased three percent mainly due to a four percent drop in average selling prices, which accounted for $30.5 million of the net sales decline. A slight increase in sales volume increased net sales by $2.2 million. The decrease in average selling prices was attributable to lower raw material costs, particularly for the last half of 2012, partially offset by a more favorable sales mix. Sales volume increased less than one percent between years as increases in sales of products used in agricultural and household and industrial cleaning applications were largely offset by decreases in sales of products used in consumer laundry and cleaning and personal care applications. Increased business with most major customers led to the improved sales volume of agricultural and household and industrial cleaning and products. Competitive pressures and lower surfactant requirements for certain customer applications accounted for the decline in sales volume for consumer laundry and personal care products. The effects of foreign currency translation reduced year-over-year net sales by $0.7 million.

Net sales for European operations declined 10 percent due to an eight percent decrease in average selling prices and the unfavorable effects of foreign currency translation, which accounted for $25.5 million and $15.7 million, respectively, of the net sales change. Sales volume improved three percent between years, which mitigated the year-over-year net sales decline by $9.6 million. Average selling prices fell as a result of raw material cost decreases. A weakening of the European euro and British pound sterling against the U.S. dollar caused the unfavorable foreign currency translation effect. Stronger demand and new business for the Company s laundry and cleaning products, particularly fabric softeners, accounted for the sales volume increase.

Net sales for Latin American operations grew six percent due to a 12 percent increase in average selling prices and a three percent increase in sales volume, which accounted for $18.0 million and $4.0 million, respectively, of the year-over-year net sales change. The unfavorable effects of foreign currency translation reduced the net sales improvement by $13.1 million. The higher average selling prices reflected a more favorable mix of sales, notably for the Brazil manufacturing plant for which the sale of higher value product was made possible by last year s addition of neutralizer capacity. A weakening of the Brazilian real and Mexican peso against the U.S. dollar led to the unfavorable currency translation effect.

Net sales for Asia operations declined eight percent due to a different mix of sales (a greater proportion of toll sales using raw material consigned by the customer) that more than offset a 19 percent improvement in sales volume. Stronger demand from existing customers and startup sales for the Singapore plant accounted for the volume increase.

Surfactants operating income for 2012 improved $17.8 million, or 18 percent, over operating income for 2011. Gross profit increased $24.9 million, or 14 percent, primarily due to improved margins resulting from a more favorable mix of sales and lower raw material costs. The two percent increase in sales volume and improved production efficiencies in Brazil also contributed to the profit growth. The effects of foreign currency translation reduced the year-over-year increase in gross profit by $3.6 million. Operating expenses increased $7.1 million, or nine percent. Year-over-year comparisons of gross profit by region and total segment operating expenses and operating income follow:

(In thousands)	For the Year Ended			
	December 31, 2012	December 31, 2011	Increase (Decrease)	Percent Change
Gross Profit				
North America	$ 155,891	$ 138,578	$ 17,313	+12
Europe	24,759	22,114	2,645	+12
Latin America	20,381	12,633	7,748	+61
Asia	2,339	5,192	(2,853)	-55
Total Surfactants Segment	$ 203,370	$ 178,517	$ 24,853	+14
Operating Expenses	84,779	77,706	7,073	+9
Operating Income	$ 118,591	$ 100,811	$ 17,780	+18

Gross profit for North American operations improved 12 percent year-over-year largely due to improved unit sales margins. A more favorable sales mix and lower year-over-year raw material costs drove the improvement. This was particularly evident in the final three months of 2012 as quarter-over-quarter gross profit increased $8.5 million. The favorable sales mix resulted from the previously noted increases in sales volumes of agricultural and household and industrial cleaning products. Although average sales prices declined between years, average raw material costs fell to a greater degree, which led to improved comparative margins.

Gross profit for European operations increased 12 percent, which was principally attributable to improved unit margins and the three percent increase in sales volume. Lower raw material costs, which outpaced declining selling prices, and reduced manufacturing expenses led to the improved margins. Manufacturing expenses were lower between years as expenses for 2011 included the effects of a planned three-week shutdown for a mandatory inspection at the Company s Germany plant. Partially offsetting the lower expenses was the impact of foreign currency translation, which lessened the year-over-year increase in gross profit by $1.5 million.

Gross profit for Latin American operations improved 61 percent mainly as a result of lower costs, favorable sales mix and higher sales volume. Gross profit for 2011 was negatively impacted by significant expenses related to the delayed start-up of the capacity expansion in Brazil. The favorable sales mix reflected a greater sales volume of neutralized products.

Gross profit for Asia operations declined 55 percent due to start-up and preproduction expenses related to the new plant in Singapore, which offset the effect of the 19 percent increase in sales volume. After delay, the Singapore plant produced trial quantities in the fourth quarter. In addition to the impact of the Singapore plant, 2011 gross profit benefited from a $1.4 million recovery of value added tax receivables in the Philippines, which were previously reserved for due to recoverability uncertainty.

Operating expenses for the surfactants segment increased $7.1 million, or nine percent, year over year. Excluding the effects of foreign currency translation, which reduced the year- over-year change by $1.9 million, operating expenses were up $9.0 million. Selling expenses increased $4.6 million, which was primarily attributable to higher salary expenses, due to increased staffing levels and pay increases, and related personnel costs (fringe benefits, incentive pay and travel) associated with the Company s growth initiatives. Also contributing to the selling expense increase was bad debt expense, which was up $0.7 million year over year primarily due to favorable reserve adjustments in 2011. Research and development expenses increased $3.8 million largely as a result of higher salary expenses and related personnel costs. Higher expenses in Europe associated with the REACH initiative contributed $0.8 million of the increase in research and development costs.

Polymers

Polymers net sales for 2012 increased $2.4 million, or one percent, over net sales for 2011. A three percent rise in sales volume and higher average selling prices accounted for $10.6 million and $3.1 million, respectively, of the increase. The unfavorable effects of foreign currency translation reduced the net sales increase by $11.3 million. Increased costs for raw materials, particularly for North American operations, led to the higher average selling prices. Europe accounted for the sales volume growth. A year-over-year comparison of net sales by region is displayed below:

(In thousands)	For the Year Ended			
	December 31, 2012	December 31, 2011	Increase (Decrease)	Percent Change
North America	$ 262,376	$ 259,713	$ 2,663	+1
Europe	135,198	133,375	1,823	+1
Asia and Other	26,385	28,427	(2,042)	-7
Total Polymers Segment	$ 423,959	$ 421,515	$ 2,444	+1

Table of Contents

Net sales for North American operations were up one percent due to a one percent increase in average selling prices, which increased year-over-year net sales by $3.8 million. Sales volume declined less than one percent, reducing the effect of the increase in average selling prices by $1.1 million. Higher phthalic anhydride raw material costs led to the increase in average selling prices. Polyol selling prices declined between 2012 and 2011 due to a lower cost for a major raw material. Sales volume for phthalic anhydride fell three percent between years primarily due to reduced demand for phthalic anhydride in plasticizer applications. Polyol sales volume grew two percent primarily as a result of greater demand for polyol used in rigid board insulation and in CASE applications, particularly in the fourth quarter. Given lower anticipated demand for phthalic anhydride, the Company reduced its manufacturing capacity by shutting down its oldest, fully depreciated reactor.

Net sales for European operations increased one percent due to a 10 percent improvement in sales volume and a less than one percent rise in average selling prices, which increased year-over-year net sales by $12.9 million and $0.6 million, respectively. The unfavorable effects of foreign currency translation reduced the net sales change by $11.7 million. The improvement in sales volume reflected new uses in metal insulation panels and adhesive polyol. A year-over-year weakening of the European euro and the Polish zloty against the U.S. dollar led to the foreign currency translation effect.

Net sales for Asia and Other operations declined seven percent between 2012 and 2011 due to a seven percent decrease in average selling prices and a one percent decrease in sales volume, which accounted for $2.0 million and $0.4 million, respectively, of the year-over-year reduction in net sales. The effects of foreign currency translation mitigated the net sales decline by $0.4 million. The lower selling prices reflected a decline in raw material costs.

Polymer operating income for 2012 increased $7.2 million, or 18 percent, over operating income for 2011. Gross profit increased $10.3 million, as all three regions reported improvements. The year-over-year increase in gross profit reflected higher margins, a large North American urethane systems sale used to insulate an aircraft carrier and increased sales volume. The impact of a second quarter planned maintenance shutdown at the North American site tempered the gross profit improvement. Operating expenses increased $3.1 million, or 15 percent. Below are year-over-year comparisons of gross profit by region and total segment operating expenses and operating income:

(In thousands)	For the Year Ended			
	December 31, 2012	December 31, 2011	Increase	Percent Change
Gross Profit				
North America	$ 50,006	$ 44,296	$ 5,710	+13
Europe	18,688	14,803	3,885	+26
Asia and Other	3,207	2,455	752	+31
Total Polymers Segment	$ 71,901	$ 61,554	$ 10,347	+17
Operating Expenses	23,771	20,645	3,126	+15
Operating Income	$ 48,130	$ 40,909	$ 7,221	+18

Table of Contents

Gross profit for North American operations increased 13 percent largely due to improved polyol margins and to the large urethane systems sale, partially offset by the effects of a planned triennial maintenance shutdown taken in the second quarter of 2012. The maintenance shutdown resulted in approximately $1.0 million of additional costs for outsourcing a portion of the Company s second quarter requirements of phthalic anhydride.

Gross profit for European operations increased 26 percent, which was attributable to improved unit margins and higher sales volumes. The increase in unit margins included the elimination of outsourced volumes necessitated in 2011 due to a reactor fire in Germany s polyol plant. Foreign currency translation had a $1.6 million negative effect on the year-over-year change in gross profit.

As noted in prior filings, in May of 2011 one of two reactors in the German polyol plant sustained fire damage. The damaged equipment was repaired and placed back into service in the fourth quarter of 2011. The Company had insurance policies to cover repair costs and business interruption losses. In the fourth quarter of 2012, the Company settled its insurance claim against one of two insurers. The settlement did not have a material effect on the Company s financial results.

Gross profit for Asia and Other operations increased 31 percent primarily due to improved margins resulting from lower raw material costs. In addition, as a result of the Company s requirement to relocate its Nanjing, China, plant, the Company reduced the useful life of the current plant s assets, thereby accelerating depreciation expense. The accelerated depreciation did not have a significant effect on profits for 2012.

Operating expenses for the polymers segment increased $3.1 million, or 15 percent, between years. Excluding the effects of foreign currency translation, the year-over-year increase was $3.7 million. Selling expenses increased $2.3 million, which was primarily attributable to higher salary expenses, due to increased staffing levels and pay increases, and the related personnel costs (fringe benefits and incentive pay). In addition, bad debt expense increased $0.4 million between years. The increase in bad debt expense reflected favorable provision adjustments made in 2011. Research and development expenses increased $0.8 million mainly due to increased salaries and related personnel costs.

Specialty Products

Net sales for 2012 increased $14.4 million, or 24 percent, over net sales for 2011. The business added when the Lipid Nutrition product lines were acquired in June 2011 accounted for the net sales improvement. Year-over-year net sales and sales volume excluding the new Lipid Nutrition business were down five percent and 13 percent, respectively, primarily for the segment s legacy multi-chain triglyceride product lines, due to lost customer share resulting from increased foreign competition. Gross profit increased $1.3 million, or seven percent, between years, due to the addition of the Lipid Nutrition product lines, but operating income fell $1.1 million, or eight percent. The combination of incremental operating expenses needed to support the Lipid Nutrition product lines and weakness in medium-chain triglyceride sales led to the operating income decline.

Table of Contents

Corporate Expenses

Corporate expenses, which comprise operating expenses that are not allocated to the reportable segments, increased $13.6 million to $50.2 million for 2012 from $36.6 million for 2011. Increases in deferred compensation expense, legal and environmental expenses and patent filing costs accounted for $8.7 million, $1.8 million and $0.8 million of the increase, respectively. Fringe benefits (which included incentive pay), salary expenses and travel-related expenses were also up year over year ($0.8 million, $0.7 million and $0.5 million, respectively).

With respect to deferred compensation, the Company recorded $10.2 million of expense for 2012 compared to $1.5 million of expense for 2011. Increases in the value of Company common stock, to which a large part the deferred compensation obligation is tied, accounted for most of the higher year-over-year deferred compensation expense. For 2012, the value of Company stock increased $15.46 per share compared to a $1.94 per share increase for 2011. The following table presents the year-end per share Company common stock prices used in the computation of deferred compensation expense:

		December 31	
	2012	2011	2010
Company Stock Price	$ 55.54	$ 40.08	$ 38.14

The increases in legal and environmental expenses and patent filing costs were primarily attributable to increased costs to support the Company s global innovation and growth activities. Revised estimates for remediation costs for three of the Company s environmental sites contributed about $0.7 million to the higher legal and environmental expenses.

The increase in fringe benefits was driven by higher bonus and profit sharing expenses that reflected the year-over-year improvement in Company earnings. Additional staffing to support the Company s growth, promotions and normal pay raises caused the increase in salary expense.

Outlook

Although the Company is experiencing a slow start to the year with severe weather impacting customer locations and Company facilities in North America, 2014 earnings should rebound as many of the events that held the Company back in 2013 should not reoccur.

In particular, Surfactant earnings are expected to be down in the first quarter due to the extreme weather and higher maintenance expenses. Earnings should improve as the year progresses, driven by greater agricultural sales, continued consumer product growth in Brazil, projected demand in enhanced oil recovery and gains from operational efficiencies. The Surfactant business will also benefit from not having approximately $9.0 million of non-recurring items.

Polymers should experience continued growth from polyol used in energy-saving rigid foam insulation. Improving economies in the U.S. and Europe, as well as further conversion of metal panel and C.A.S.E. customers, should contribute to volume growth in 2014. The North

Table of Contents

American polyester resin business purchased from BMS is fully integrated and is positioned to deliver projected benefits in 2014. In China, the Company expects to continue to incur higher supply costs in 2014 lowering margins, but the shutdown cost recognized in 2013 will not reoccur.

Liquidity and Financial Condition

For the year ended December 31, 2013, operating activities were a cash source of $150.3 million versus $109.0 million in 2012. For the current year, investing cash outflows totaled $167.6 million and non-debt financing activities consumed $11.0 million. To fund these cash requirements, the Company increased debt by $87.2 million.

For the current year, net income was down by $7.4 million and working capital consumed $28.3 million less than for the prior year. Cash outflows for investing activities were up by $80.1 million year over year. Cash provided by financing activities was a source of $76.3 million in 2013 compared to a use of $29.5 million in 2012.

For the current year, accounts receivable were a use of $12.7 million compared to a source of $3.9 million in 2012. Inventories were a use of $3.8 million in 2013 versus a use of $50.3 million in 2012. Accounts payable and accrued liabilities were a source of $26.3 million in 2013 compared to a source of $24.1 million for 2012.

During 2013, changes in raw material costs had relatively little effect on working capital, while during 2012 the Company experienced lower material costs, which mitigated the cash impact on receivables of higher fourth-quarter sales volumes and higher inventory quantities versus the comparable quarter of the previous year. 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 was 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 December 31, 2013 and turnover was not a significant factor in the year-over-year cash flow comparisons. The inventory cash use for the year of 2013 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 2014.

Investing cash outflows for the current year included capital expenditures of $92.9 million compared to $83.2 million last year. Current year 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 $6.5 million in 2013 versus $4.3 million in 2012.

For 2014, the Company estimates that capital expenditures will range from $115 million to $125 million including capacity expansions in the United States and Brazil.

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

Table of Contents

twelve months of 2013, the Company purchased 41,688 shares in the open market at a total cost of $2.3 million. At December 31, 2013, there were 958,312 shares remaining under the current share repurchase authorization. Also, in connection with the redemption 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. In accordance with the Preferred Shareholders Agreement, the Company redeemed 835 unconverted 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.

At December 31, 2013, the Company s cash and cash equivalents totaled $133.3 million, including $66.0 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 $15.9 million and cash of the Company s non-U.S. subsidiaries held outside the U.S. totaled $51.4 million as of December 31, 2013.

Consolidated balance sheet debt increased by $88.2 million for the current year, from $182.4 million to $270.6 million. Since last year end, domestic debt increased by $90.0 million and foreign debt decreased by $1.8 million. Net debt (which is defined as total debt minus cash) increased by $31.8 million for the current year, from $105.5 million to $137.3 million. As of December 31, 2013, the ratio of total debt to total debt plus shareholders equity was 32.8 percent compared to 27.5 percent at December 31, 2012. As of December 31, 2013, the ratio of net debt to net debt plus shareholders equity was 19.9 percent compared to 18.0 percent at December 31, 2012.

At December 31, 2013, the Company s debt included $242.1 million of unsecured private placement loans with maturities extending from 2014 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 percent with interest to be paid semi-annually and with equal annual principal payments beginning on Ju