

STEPAN CO
Form 10-Q
July 29, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(MARK ONE)

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2016

☐ 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	(I.R.S. Employer
of incorporation or organization)	Identification Number)
Edens and Winnetka Road, Northfield, Illinois 60093	

(Address of principal executive offices)

Registrant's telephone number (847) 446-7500

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

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

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

(Check one): Large accelerated filer ☒ Accelerated filer ☐

Non-accelerated filer ☐ Smaller reporting company ☐

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

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

Class	Outstanding at July 21, 2016
Common Stock, \$1 par value	22,364,316 Shares

Part I FINANCIAL INFORMATION

Item 1 - Financial Statements

STEPAN COMPANY

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

Unaudited

	Three Months Ended		Six Months Ended	
(In thousands, except per share amounts)	June 30 2016	2015	June 30 2016	2015
Net Sales	\$454,603	\$452,414	\$900,500	\$912,865
Cost of Sales	361,672	372,902	714,070	756,911
Gross Profit	92,931	79,512	186,430	155,954
Operating Expenses:				
Selling	14,572	14,265	28,262	27,262
Administrative ^(a)	17,692	17,482	36,392	35,244
Research, development and technical services	14,256	12,597	28,038	24,387
Deferred compensation expense ^(a)	2,434	6,573	5,154	8,150
	48,954	50,917	97,846	95,043
Gain on sale of product line	—	—	—	2,862
Business restructuring	(1,061)	—	(1,061)	—
Operating Income	42,916	28,595	87,523	63,773
Other Income (Expense):				
Interest, net	(3,417)	(2,869)	(7,031)	(6,923)
Loss from equity in joint ventures (Note 16)	—	(1,815)	—	(3,055)
Other, net (Note 13)	(303)	235	(828)	887
	(3,720)	(4,449)	(7,859)	(9,091)
Income Before Provision for Income Taxes	39,196	24,146	79,664	54,682
Provision for Income Taxes	11,326	7,205	24,137	16,455
Net Income	27,870	16,941	55,527	38,227
Net Income Attributable to				
Noncontrolling Interests (Note 2)	(5)	(27)	(8)	(43)
Net Income Attributable to Stepan Company	\$27,865	\$16,914	\$55,519	\$38,184
Net Income Per Common Share Attributable to Stepan Company (Note 9):				
Basic	\$1.22	\$0.74	\$2.44	\$1.68
Diluted	\$1.21	\$0.74	\$2.42	\$1.67

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Shares Used to Compute Net Income Per Common Share Attributable to Stepan Company (Note 9):

Basic	22,760	22,742	22,746	22,731
Diluted	22,958	22,871	22,920	22,850

Dividends Declared Per Common Share	\$0.19	\$0.18	\$0.38	\$0.36
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(a) For the three and six months ended June 30, 2015, deferred compensation expense was included in the administrative expense line. The 2015 amounts have been classified separately to conform to the current year presentation.

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

STEPAN COMPANY

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Unaudited

	Three Months Ended		Six Months Ended	
(In thousands)	June 30		June 30	
	2016	2015	2016	2015
Net income	\$27,870	\$16,941	\$55,527	\$38,227
Other comprehensive income (loss):				
Foreign currency translation adjustments (Note 10)	(2,692)	5,957	9,898	(19,195)
Pension liability adjustment, net of tax (Note 10)	565	750	1,129	1,499
Derivative instrument activity, net of tax (Note 10)	(6)	16	(27)	(26)
Other comprehensive income (loss)	(2,133)	6,723	11,000	(17,722)
Comprehensive income	25,737	23,664	66,527	20,505
Comprehensive (income) loss attributable to noncontrolling interests (Note 2)	39	(44)	25	(45)
Comprehensive income attributable to Stepan Company	\$25,776	\$23,620	\$66,552	\$20,460

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

STEPAN COMPANY

CONDENSED CONSOLIDATED BALANCE SHEETS

Unaudited

(In thousands)	June 30, 2016	December 31, 2015
Assets		
Current Assets:		
Cash and cash equivalents	\$ 190,411	\$ 176,143
Receivables, net	285,058	249,602
Inventories (Note 6)	180,651	170,424
Other current assets	23,219	23,404
Total current assets	679,339	619,573
Property, Plant and Equipment:		
Cost	1,477,841	1,446,098
Less: accumulated depreciation	(914,231)	(890,635)
Property, plant and equipment, net	563,610	555,463
Goodwill, net	11,292	11,265
Other intangible assets, net	16,561	17,957
Long-term investments (Note 3)	21,225	20,910
Other non-current assets (Note 18)	12,448	13,224
Total assets	\$ 1,304,475	\$ 1,238,392
Liabilities and Equity		
Current Liabilities:		
Current maturities of long-term debt (Note 12)	\$ 14,377	\$ 18,806
Accounts payable	144,161	128,605
Accrued liabilities	83,720	95,833
Total current liabilities	242,258	243,244
Deferred income taxes	15,314	9,455
Long-term debt, less current maturities (Note 12 and 18)	306,980	312,548
Other non-current liabilities	119,664	114,761
Commitments and Contingencies (Note 7)		
Equity:		
Common stock, \$1 par value; authorized 60,000,000 shares;		
Issued shares 25,792,832 in 2016 and 25,709,391 shares in 2015	25,793	25,709
Additional paid-in capital	150,834	144,601
Accumulated other comprehensive loss (Note 10)	(114,055)	(125,088)
Retained earnings	627,250	580,208
Less: Common treasury stock, at cost, 3,470,084 shares in 2016		
and 3,428,541 shares in 2015	(70,938)	(68,446)
Total Stepan Company stockholders' equity	618,884	556,984
Noncontrolling interests (Note 2)	1,375	1,400
Total equity	620,259	558,384
Total liabilities and equity	\$ 1,304,475	\$ 1,238,392

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

STEPAN COMPANY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

Unaudited

(In thousands)	Six Months Ended	
	June 30	
	2016	2015
Cash Flows From Operating Activities		
Net income	\$55,527	\$38,227
Adjustments to reconcile net income to net cash		
provided by operating activities:		
Depreciation and amortization	36,453	32,859
Deferred compensation	5,154	8,150
Realized and unrealized losses (gains) on long-term investments	205	(642)
Stock-based compensation	4,448	3,162
Deferred income taxes	6,146	(1,953)
Other non-cash items	1,165	508
Changes in assets and liabilities:		
Receivables, net	(33,586)	(679)
Inventories	(8,664)	(245)
Other current assets	335	(2,438)
Accounts payable and accrued liabilities	8,586	3,386
Pension liabilities	365	358
Environmental and legal liabilities	767	(1,408)
Deferred revenues	(564)	(781)
Excess tax benefit from stock options and awards	(893)	(236)
Net Cash Provided By Operating Activities	75,444	78,268
Cash Flows From Investing Activities		
Expenditures for property, plant and equipment	(40,696)	(54,021)
Business acquisition (Note 17)	—	(5,133)
Proceeds from sale of product line (Note 14)	—	3,262
Other, net	(3,533)	(1,746)
Net Cash Used In Investing Activities	(44,229)	(57,638)
Cash Flows From Financing Activities		
Revolving debt and bank overdrafts, net	(3,971)	(9,435)
Other debt repayments	(6,033)	(2,503)
Dividends paid	(8,477)	(8,061)
Company stock repurchased	(2,408)	—
Stock option exercises	1,351	359
Excess tax benefit from stock options and awards	893	236
Other, net	(235)	(275)
Net Cash Used In Financing Activities	(18,880)	(19,679)
Effect of Exchange Rate Changes on Cash	1,933	(3,801)
Net Increase (Decrease) in Cash and Cash Equivalents	14,268	(2,850)

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Cash and Cash Equivalents at Beginning of Period	176,143	85,215
Cash and Cash Equivalents at End of Period	\$190,411	\$82,365
Supplemental Cash Flow Information		
Cash payments of income taxes, net of refunds	\$11,074	\$6,873
Cash payments of interest	\$7,442	\$6,046

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

STEPAN COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2016

Unaudited

1.CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The condensed consolidated financial statements included herein have been prepared by Stepan Company (Company), without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) have been condensed or omitted pursuant to such rules and regulations, although management believes that the disclosures are adequate and make the information presented not misleading. In the opinion of management, all adjustments, consisting only of normal recurring accruals, necessary to present fairly the Company's financial position as of June 30, 2016, and its results of operations for the three and six months ended June 30, 2016 and 2015, and cash flows for the six months ended June 30, 2016 and 2015, have been included. These financial statements and related footnotes should be read in conjunction with the financial statements and related footnotes included in the Company's 2015 Form 10-K.

2.RECONCILIATIONS OF EQUITY

Below are reconciliations of total equity, Company equity and equity attributable to noncontrolling interests for the six months ended June 30, 2016 and 2015:

		Stepan Company	Noncontrolling Interests'
(In thousands)	Total Equity	Equity	Equity ⁽³⁾
Balance at January 1, 2016	\$558,384	\$556,984	\$ 1,400
Net income	55,527	55,519	8
Dividends	(8,477)	(8,477)	—
Common stock purchases ⁽¹⁾	(2,643)	(2,643)	—
Stock option exercises	1,351	1,351	—
Defined benefit pension adjustments, net of tax	1,129	1,129	—
Translation adjustments	9,898	9,931	(33)
Derivative instrument activity, net of tax	(27)	(27)	—
Other ⁽²⁾	5,117	5,117	—
Balance at June 30, 2016	\$620,259	\$618,884	\$ 1,375

	Stepan		
	Company		Noncontrolling Interests'
(In thousands)	Total Equity	Equity	Equity ⁽³⁾
Balance at January 1, 2015	\$536,944	\$535,546	\$ 1,398
Net income	38,227	38,184	43
Dividends	(8,061)	(8,061)	—
Common stock purchases ⁽¹⁾	(273)	(273)	—
Stock option exercises	359	359	—
Defined benefit pension adjustments, net of tax	1,499	1,499	—
Translation adjustments	(19,195)	(19,197)	2
Derivative instrument activity, net of tax	(26)	(26)	—
Other ⁽²⁾	2,488	2,488	—
Balance at June 30, 2015	\$551,962	\$550,519	\$ 1,443

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

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

⁽³⁾Reflects the noncontrolling interest in the Company's China joint venture.

3. FAIR VALUE MEASUREMENTS

The following describe the financial instruments held by the Company at June 30, 2016, and December 31, 2015, and the methods and assumptions used to estimate the instruments' fair values:

Cash and cash equivalents

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

Derivative assets and liabilities

Derivative assets and liabilities included the foreign currency exchange and interest rate contracts discussed in Note 4. Fair value and carrying value were the same because the contracts were recorded at fair value. The fair values of the foreign currency contracts were calculated as the difference between the applicable forward foreign exchange rates at the reporting date and the contracted foreign exchange rates multiplied by the contracted notional amounts. The fair values of the interest rate swaps were calculated as the difference between the contracted swap rate and the current market replacement swap rate multiplied by the present value of one basis point for the notional amount of the contract. See the table that follows the financial instrument descriptions for the reported fair values of derivative assets and liabilities.

Long-term investments

Long-term investments included the mutual fund assets the Company held to fund a portion of its deferred compensation liabilities and all of its non-qualified supplemental executive defined contribution obligations (see the defined contribution plans section of Note 8). Fair value and carrying value were the same because the mutual fund assets were recorded at fair value in accordance with the fair value option rules established by the Financial Accounting Standards Board (FASB). Fair values for the mutual funds were calculated using the published market price per unit at the reporting date multiplied by the number of units held at the reporting date. See the table that follows the financial instrument descriptions for the reported fair value of long-term investments.

Debt obligations

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

At June 30, 2016, and December 31, 2015, the fair values of debt and the related carrying values, including current maturities, were as follows (the fair value and carrying value amounts are shown without regard to unamortized debt issuance costs):

	June 30,	December 31,
	2016	2015
(In thousands)		
Fair value	\$333,229	\$331,183
Carrying value	322,550	332,623

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The following tables present financial assets and liabilities measured on a recurring basis at fair value as of June 30, 2016, and December 31, 2015, and the level within the fair value hierarchy in which the fair value measurements fall:

(In thousands)	June		Level	Level
	2016	Level 1	2	3
Mutual fund assets	\$21,225	\$21,225	\$—	\$ —
Derivative assets:				
Foreign currency contracts	339	—	339	—
Total assets at fair value	\$21,564	\$21,225	\$339	\$ —
Derivative liabilities:				
Foreign currency contracts	\$591	\$—	\$591	\$ —
Interest rate contracts	86	—	86	—
Total liabilities at fair value	\$677	\$—	\$677	\$ —

	December			
(In thousands)	2015	Level 1	Level 2	Level 3
Mutual fund assets	\$ 20,910	\$20,910	\$—	\$ —
Derivative assets:				
Foreign currency contracts	112	—	112	—
Total assets at fair value	\$ 21,022	\$20,910	\$ 112	\$ —
Derivative liabilities :				
Foreign currency contracts	\$ 305	\$—	\$ 305	\$ —
Interest rate contracts	53	—	53	—
Total liabilities at fair value	\$ 358	\$—	\$ 358	\$ —

4. DERIVATIVE INSTRUMENTS

The Company is exposed to certain risks relating to its ongoing business operations. The primary risk managed by the use of derivative instruments is foreign currency exchange risk. The Company holds forward foreign currency exchange contracts that are not designated as any type of accounting hedge as defined by U.S. GAAP. The Company uses these contracts to manage its exposure to exchange rate fluctuations on certain Company subsidiary cash, accounts receivable, accounts payable and other obligation balances that are denominated in currencies other than the entities' functional currencies. The forward foreign exchange contracts are recognized on the balance sheet as either an asset or a liability measured at fair value. Gains and losses arising from recording the foreign exchange contracts at fair value are reported in earnings as offsets to the losses and gains reported in earnings arising from the re-measurement of the asset and liability balances into the applicable functional currencies. At June 30, 2016, and December 31, 2015, the Company had open forward foreign currency exchange contracts, all with settlement dates of approximately one month, to buy or sell foreign currencies with U.S. dollar equivalent amounts of \$35,754,000 and \$31,194,000, respectively.

The Company is exposed to volatility in short-term interest rates and mitigates certain portions of that risk by using interest rate swaps. The interest rate swaps are recognized on the balance sheet as either an asset or a liability measured at fair value. The Company held interest rate swap contracts with notional values of \$3,491,000 at June 30, 2016, and \$3,724,000 at December 31, 2015. The contracts were designated as cash flow hedges. Period-to-period changes in the fair value of interest rate swap contracts are recognized as gains or losses in other comprehensive income, to the extent effective. As each interest rate swap hedge contract is settled, the corresponding gain or loss is reclassified out of accumulated other comprehensive income (AOCI) into earnings in that settlement period. The latest date through which the Company expects to hedge its exposure to the volatility of short-term interest rates is December 1, 2021.

The fair values of the derivative instruments held by the Company on June 30, 2016, and December 31, 2015, are disclosed in Note 3. Derivative instrument gains and losses for the three- and six-month periods ending June 30, 2016 and 2015, were immaterial. For amounts reclassified out of AOCI into earnings for the three- and six-month periods ended June 30, 2016 and 2015, see Note 10.

5. STOCK-BASED COMPENSATION

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On June 30, 2016, the Company had stock options outstanding under its 2006 Incentive Compensation Plan and stock options, stock awards and stock appreciation rights (SARs) outstanding under its 2011 Incentive Compensation Plan.

Compensation expense recorded for all stock options, stock awards and SARs was as follows:

(In thousands)			
Three Months Ended		Six Months Ended	
June 30		June 30	
2016	2015	2016	2015
\$2,025	\$2,364	\$4,448	\$3,162

The increase in stock-based compensation expense between the six-month periods ended June 30, 2016 and 2015, was primarily attributable to increased compensation related to performance awards. The increase resulted from management's assessment that the profitability performance metrics for certain grants would be achieved at greater levels than previously estimated.

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

(In thousands)	June 30, 2016	December 31, 2015
Stock options	\$ 1,564	\$ 784
Stock awards	5,704	3,396
SARs	3,260	1,644

The increases in unrecognized compensation costs for stock options, stock awards and SARs reflected the 2016 grants of:

	Shares
Stock options	104,226
Stock awards (at target)	72,997
SARs	214,164

The unrecognized compensation costs at June 30, 2016, are expected to be recognized over weighted-average periods of 1.4 years, 2.1 years and 1.4 years for stock options, stock awards and SARs, respectively.

6. INVENTORIES

The composition of inventories was as follows:

(In thousands)	June 30, 2016	December 31, 2015
Finished goods	\$ 129,734	\$ 124,481
Raw materials	50,917	45,943
Total inventories	\$ 180,651	\$ 170,424

Inventories are priced primarily using the last-in, first-out inventory valuation method. If the first-in, first-out inventory valuation method had been used for all inventories, total inventory balances would have been approximately \$25,863,000 and \$18,171,000 higher than reported at June 30, 2016, and December 31, 2015, respectively.

7. CONTINGENCIES

There are a variety of legal proceedings pending or threatened against the Company. Some of these proceedings may result in fines, penalties, judgments or costs being assessed against the Company at some future time. The Company's operations are subject to extensive local, state and federal regulations, including the U.S. Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA) and the Superfund amendments of 1986 (Superfund). Over the years, the Company has received requests for information related to or has been named by the government as a potentially responsible party (PRP) at a number of waste disposal sites where 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.

As of June 30, 2016, the Company estimated a range of possible environmental and legal losses of \$21.7 million to \$42.4 million. At June 30, 2016, and December 31, 2015, the Company's accrued liability for such losses, which represented the Company's best estimate within the estimated range of possible environmental and legal losses, was \$21.7 million and \$20.9 million, respectively. During the first six months of 2016 and 2015, cash outlays related to legal and environmental matters approximated \$0.6 and \$1.9 million, respectively.

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

cleanup, and the extended period over which any costs would be incurred, the Company believes that these matters, individually and in the aggregate, will not have a material effect on the Company's financial position.

Following are summaries of the material contingencies at June 30, 2016:

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 United States Environmental Protection Agency (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, and on September 24, 2014, USEPA issued its Record of Decision (ROD) for chemically-contaminated soil. USEPA has not yet issued a ROD for chemically-contaminated groundwater for the Maywood site. Based on the most current information available, the Company believes its recorded liability represents its best estimate of the cost of remediation for the Maywood site. The best estimate of the cost of remediation for the Maywood site could change as the Company continues to hold discussions with USEPA, as the design of the remedial action progresses or if other PRPs are identified. The ultimate amount for which the Company is liable could differ from the Company's current recorded liability.

In April 2015, the Company entered into an Administrative Settlement Agreement and Administrative Order on Consent with USEPA which requires payment of certain costs and performance of certain investigative and design work for chemically-contaminated soil. Based on the Company's review and analysis of this order, no changes to the Company's recorded liability for claims associated with soil remediation of chemical contamination were required.

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

D'Imperio Property Site

During the mid-1970's, Jerome Lightman and the Lightman Drum Company disposed of hazardous substances at several sites in New Jersey. The Company was named as a 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 2016, the PRPs were provided with updated remediation cost estimates which were considered in the Company's determination of its range of estimated possible losses and liability balance. The change 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 \$2.5 million for the Company's portion of environmental response costs. 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 its recorded liability for the claims related to this site is adequate. 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.

Mexico Value-Added Tax

In the first quarter of 2015, during an examination of the 2009 and 2010 financial records of the Company's Mexico subsidiary, local tax authority auditors determined that the Company's treatment of value-added tax (VAT) for purchase transactions with a certain vendor was incorrect. As a result, the tax authorities concluded that the Company owed past VAT from 2009-2010 along with assessed inflation, penalty and interest charges. Consequently, the Company recorded a liability and corresponding income statement charge for the VAT inflation, penalty and interest charges. The liability included the 2009-2010 assessment of inflation, penalty and interest charges plus an estimated amount for the potential exposure for 2011-2014. The amount recorded was not material to the Company's results of operations. No charge was recorded for the past unpaid VAT because the Company believes the amount will be recoverable through the normal VAT process. No exposure for years after 2014 exists as the Company remedied the underlying issue that led to the tax authorities' determination. In February 2016, the Company reached agreement with Mexico's tax authorities on the amount of inflation, penalty and interest charged for the 2009 and 2010 years under audit. No significant adjustments were required to the previously recorded liability. Depending on the outcomes of future negotiations with Mexico tax authorities regarding the years 2011-2014 and the actual amount of the past VAT that is recovered by the Company, the final actual settlement could differ from the current recorded liability.

8. POSTRETIREMENT BENEFIT PLANS

Defined Benefit Pension Plans

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

Components of Net Periodic Benefit Cost

(In thousands)	UNITED STATES			
	Three Months Ended		Six Months Ended	
	June 30 2016	2015	June 30 2016	2015
Interest cost	\$1,730	\$1,702	\$3,459	\$3,403
Expected return on plan assets	(2,254)	(2,393)	(4,508)	(4,786)
Amortization of net actuarial loss	882	1,149	1,764	2,298
Net periodic benefit cost	\$358	\$458	\$715	\$915

(In thousands)	UNITED KINGDOM			
	Three Months Ended		Six Months Ended	
	June 30 2016	2015	June 30 2016	2015
Interest cost	\$194	\$198	\$387	\$393
Expected return on plan assets	(238)	(265)	(476)	(527)
Amortization of net actuarial loss	20	46	40	91
Net periodic benefit (income) cost	\$(24)	\$(21)	\$(49)	\$(43)

Employer Contributions

U.S. Plans

As a result of pension funding relief provisions included in the Highway and Transportation Funding Act of 2014, the Company expects to make no 2016 contributions to the funded U.S. qualified defined benefit plans. Approximately, \$178,000 is expected to be paid related to the unfunded non-qualified plans in 2016. As of June 30, 2016, \$133,000 had been paid related to the non-qualified plans in 2016.

U.K. Plan

The Company's United Kingdom subsidiary expects to contribute approximately \$361,000 to its defined benefit pension plan in 2016. As of June 30, 2016, \$176,000 had been contributed to the plan in 2016.

Defined Contribution Plans

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

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

	Three Months Ended		Six Months Ended	
(In thousands)	June 30		June 30	
	2016	2015	2016	2015
Retirement savings plans	\$ 1,254	\$ 1,136	\$ 2,545	\$ 2,320
Profit sharing plan	1,786	1,211	3,503	2,191
Total defined contribution expense	\$3,040	\$2,347	\$6,048	\$4,511

The Company funds the obligations of its non-qualified supplemental executive defined contribution plans (supplemental plans) through a rabbi trust. The trust comprises various mutual fund investments selected by the participants of the supplemental plans. In accordance with the accounting guidance for rabbi trust arrangements, the assets of the trust and the obligations of the supplemental plans are reported on the Company's consolidated balance sheets. The Company elected the fair value option for the mutual fund investment assets so that offsetting changes in the mutual fund values and defined contribution plan obligations would be recorded in earnings in the same period. Therefore, the mutual funds are reported at fair value with any subsequent changes in fair value recorded in the consolidated statements of income. The liabilities related to the supplemental plans increase (i.e., supplemental plan expense is recognized) when the value of the trust assets appreciates and decrease when the value of the trust assets declines (i.e., supplemental plan income is recognized). At June 30, 2016, the balance of the trust assets was \$1,753,000, which equaled the balance of the supplemental plan liabilities (see the long-term investments section in Note 3 for further information regarding the Company's mutual fund assets).

9.EARNINGS PER SHARE

Below are the computations of basic and diluted earnings per share for the three and six months ended June 30, 2016 and 2015:

	Three Months Ended		Six Months Ended	
(In thousands, except per share amounts)	June 30		June 30	
	2016	2015	2016	2015
Computation of Basic Earnings per Share				
Net income attributable to Stepan Company	\$27,865	\$16,914	\$55,519	\$38,184
Weighted-average number of common shares outstanding	22,760	22,742	22,746	22,731
Basic earnings per share	\$1.22	\$0.74	\$2.44	\$1.68

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Computation of Diluted Earnings per Share				
Net income attributable to Stepan Company	\$27,865	\$16,914	\$55,519	\$38,184
Weighted-average number of shares outstanding	22,760	22,742	22,746	22,731
Add weighted-average net shares issuable from assumed				
exercise of options (under treasury stock method) ⁽¹⁾	125	127	119	116
Add weighted-average net shares related to unvested				
stock awards (under treasury stock method)	5	2	5	3
Add weighted-average net shares from assumed exercise				
of SARS (under treasury stock method)	38	—	23	—
Add weighted-average contingently issuable net shares				
related to performance stock awards (under treasury				
stock method)	30	—	27	—
Weighted-average shares applicable to diluted earnings	22,958	22,871	22,920	22,850
Diluted earnings per share	\$1.21	\$0.74	\$2.42	\$1.67

⁽¹⁾ Options to purchase 85,243 and 87,430 shares of Company common stock were excluded from the computations of diluted earnings per share for the three and six months ended June 30, 2016, respectively. Options to purchase 91,678 and 158,888 shares of Company common stock were excluded from the computations of diluted earnings per share for the three and six months ended June 30, 2015, respectively. The options' exercise prices were greater than the average market price for the common stock and their effect would have been antidilutive.

10. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

Below are the changes in the Company's accumulated other comprehensive income (loss) (AOCI) balances by component (net of income taxes) for the three and six months ended June 30, 2015 and 2016:

	Foreign Currency Translation	Defined Benefit Pension Plan	Cash Flow Hedge	
(In thousands)	Adjustments	Adjustments	Adjustments	Total
Balance at March 31, 2015	\$ (68,051)	\$ (40,400)	\$ 76	\$(108,375)
Other comprehensive income before reclassifications	5,940	—	16	5,956
Amounts reclassified from AOCI	—	750	—	750
Net current-period other comprehensive income	5,940	750	16	6,706
Balance at June 30, 2015	\$ (62,111)	\$ (39,650)	\$ 92	\$(101,669)
Balance at March 31, 2016	\$ (75,758)	\$ (36,261)	\$ 53	\$(111,966)
Other comprehensive income before reclassifications	(2,648)	—	(9)	(2,657)
Amounts reclassified from AOCI	—	565	3	568
Net current-period other comprehensive income	(2,648)	565	(6)	(2,089)
Balance at June 30, 2016	\$ (78,406)	\$ (35,696)	\$ 47	\$(114,055)
Balance at December 31, 2014	\$ (42,914)	\$ (41,149)	\$ 118	\$(83,945)
Other comprehensive income before reclassifications	(19,197)	—	(27)	\$(19,224)
Amounts reclassified from AOCI	—	1,499	1	\$1,500
Net current-period other comprehensive income	(19,197)	1,499	(26)	(17,724)
Balance at June 30, 2015	\$ (62,111)	\$ (39,650)	\$ 92	\$(101,669)
Balance at December 31, 2015	\$ (88,337)	\$ (36,825)	\$ 74	\$(125,088)
Other comprehensive income before reclassifications	9,931	—	(32)	9,899
Amounts reclassified from AOCI	—	1,129	5	1,134
Net current-period other comprehensive income	9,931	1,129	(27)	11,033
Balance at June 30, 2016	\$ (78,406)	\$ (35,696)	\$ 47	\$(114,055)

Information regarding the reclassifications out of AOCI for the three and six months ended June 30, 2016 and 2015, is displayed below:

(In thousands)	Amount Reclassified from AOCI ^(a)			Affected Line Item in
	Three Months Ended	Six Months Ended	Consolidated Statements	
AOCI Components	June 30	June 30	of Income	

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	2016	2015	2016	2015	
Amortization of defined benefit pension actuarial losses	\$(902)	\$(1,195)	\$(1,804)	\$(2,389)	(b)
	337	445	675	890	Tax benefit
	\$(565)	\$(750)	\$(1,129)	\$(1,499)	Net of tax
Gains and losses on cash flow hedges:					
Interest rate contracts	\$(7)	\$(5)	\$(13)	\$(10)	Interest, net
Foreign exchange contracts	2	3	4	5	Cost of sales
	(5)	(2)	(9)	(5)	Total before tax
	2	2	4	4	Tax benefit
	\$(3)	\$-	\$(5)	\$(1)	Net of tax
Total reclassifications for the period	\$(568)	\$(750)	\$(1,134)	\$(1,500)	Net of tax

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

(b) This component of accumulated other comprehensive income is included in the computation of net periodic benefit cost (see Note 8 for additional details).

11. SEGMENT REPORTING

The Company has three reportable segments: Surfactants, Polymers and Specialty Products. Net sales by segment for the three and six months ended June 30, 2016 and 2015, were as follows:

	Three Months Ended		Six Months Ended	
(In thousands)	June 30		June 30	
	2016	2015	2016	2015
Segment Net Sales				
Surfactants	\$298,587	\$299,743	\$608,547	\$630,294
Polymers	134,498	133,613	248,396	242,977
Specialty Products	21,518	19,058	43,557	39,594
Total	\$454,603	\$452,414	\$900,500	\$912,865

Segment operating income and reconciliations of segment operating income to consolidated income before income taxes for the three and six months ended June 30, 2016 and 2015, are summarized below:

	Three Months Ended		Six Months Ended	
(In thousands)	June 30		June 30	
	2016	2015	2016	2015
Segment Operating Income				
Surfactants	\$27,232	\$24,232	\$64,477	\$57,996
Polymers	30,994	23,429	53,191	38,214
Specialty Products	1,788	1,522	4,121	3,766
Segment operating income	60,014	49,183	121,789	99,976
Business restructuring	(1,061)	—	(1,061)	—
Unallocated corporate expenses ⁽¹⁾	(16,037)	(20,588)	(33,205)	(36,203)
Consolidated operating income	42,916	28,595	87,523	63,773
Interest expense, net	(3,417)	(2,869)	(7,031)	(6,923)
Loss from equity in joint ventures	—	(1,815)	—	(3,055)
Other, net	(303)	235	(828)	887
Consolidated income before income taxes	\$39,196	\$24,146	\$79,664	\$54,682

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

12. DEBT

At June 30, 2016, and December 31, 2015, debt comprised the following:

	Maturity	June 30,	December
(In thousands)	Dates	2016	31, 2015
Unsecured private placement notes			
3.95% (net of unamortized debt issuance cost of			
\$366 and \$383 for 2016 and 2015, respectively)	2021-2027	\$99,634	\$99,617
3.86% (net of unamortized debt issuance cost of			
\$417 and \$440 for 2016 and 2015, respectively)	2019-2025	99,583	99,560
4.86% (net of unamortized debt issuance cost of			
\$244 and \$260 for 2016 and 2015, respectively)	2017-2023	64,756	64,740
5.88% (net of unamortized debt issuance cost of			
\$129 and \$140 for 2016 and 2015, respectively)	2016-2022	34,157	39,860
5.69% (net of unamortized debt issuance cost of			
\$38 and \$46 for 2016 and 2015, respectively)	2016-2018	17,104	17,096
Unsecured U.S. Bank Debt	2019		—
Debt of foreign subsidiaries			
Unsecured bank debt, foreign currency	2016	151	4,810
Unsecured bank term loan, foreign currency	2021	3,491	3,724
Secured bank debt, foreign currency	2016	2,481	1,947
Total debt		\$321,357	\$331,354
Less current maturities		14,377	18,806
Long-term debt		\$306,980	\$312,548

The Company has a committed \$125,000,000 multi-currency revolving credit agreement that expires in July 2019. The Company maintains standby letters of credit under its workers' compensation insurance agreements and for other purposes, as needed from time to time, which are issued under the revolving credit agreement. As of June 30, 2016, the Company had outstanding letters of credit totaling \$4,927,000 and no outstanding borrowing under the revolving credit agreement. There was \$120,073,000 available under the revolving credit agreement as of June 30, 2016.

The various loan agreements contain provisions which, among others, require maintenance of certain financial ratios and place limitations on additional debt, investments and payment of dividends. Based on the loan agreement provisions that place limitations on dividend payments, unrestricted retained earnings (i.e., retained earnings available for dividend distribution) were \$146,434,000 and \$119,891,000 at June 30, 2016 and December 31, 2015, respectively.

Net debt (which is defined as total debt minus cash) was \$130,946,000 at June 30, 2016 compared to \$155,211,000 at December 31, 2015.

13. OTHER, NET

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

	Three Months Ended		Six Months Ended	
(In thousands)	June 30		June 30	
	2016	2015	2016	2015
Foreign exchange gain (loss)	\$(464)	\$101	\$(775)	\$99
Investment income	60	23	152	146
Realized and unrealized gains (loss) on investments	101	111	(205)	642
Other, net	\$(303)	\$235	\$(828)	\$887

14. SALE OF PRODUCT LINE

In January 2015, the Company sold its specialty polyurethane systems product line (kits) to J6 Polymers, LLC (J6) for cash of \$3,262,000. Kits were a part of the Company's Polymers segment. The sale of kits included inventory, customer and supplier lists, formulations, manufacturing procedures and all other intellectual property associated with the manufacturing and selling of kits. As a result of the sale, Company operating income for the six months ended June 30, 2015, included a pretax gain of \$2,862,000. The gain was attributed to the Polymer segment. J6 is a business wholly-owned and operated by members of the immediate family of Robert J. Wood, a former Company executive who retired from the Company in April 2014. Mr. Wood is a managing member of J6.

15. BUSINESS RESTRUCTURING

In May 2016, the Company announced plans to shut down its Longford Mills, Canada, facility, a part of the Surfactants reportable segment, by the end of 2016. Execution of this plan will result in a workforce reduction of approximately 30 employees. Production of goods currently manufactured at the Longford Mill's facility will be moved to other Company North American production sites. The plant closure is expected to enable the Company to improve its asset utilization in North America and to further reduce the Company's fixed cost base. For the three and six months ended June 30, 2016, the Company recognized \$1,061,000 of restructuring expenses, all of which related to employee termination costs. Additional plant closure costs, including decommissioning, are estimated to be \$3,000,000 and are expected to be recognized as incurred in the final half of 2016. Earlier in the year, the Company announced the discontinuation of ethoxylation production at the site in the first quarter of 2016.

In addition to the restructuring costs, the Company reduced the useful lives of the manufacturing assets in the Longford Mills plant. As a result, the Company recognized \$843,000 and \$1,927,000 of additional depreciation expense for the three and six months ended June 30, 2016, respectively (including first quarter depreciation of \$1,084,000 related to the ethoxylation assets). The expense was included in the cost of sales line of the consolidated statements of income. The change in the useful lives of the assets will add about \$2,600,000 of depreciation expense in the second half of 2016.

16. TIORCO, LLC JOINT VENTURE

In October 2015, the Company and its partner, Nalco Company (a subsidiary of Ecolab Inc.), made the decision to dissolve their equally owned and operated TIORCO, LLC (TIORCO) enhanced oil recovery joint venture. As a result of the dissolution, TIORCO incurred fourth quarter 2015 exit costs, for which the Company recorded its share in the three- and twelve-month periods ended December 31, 2015. The Company made a final cash investment of \$2,900,000 to TIORCO during the three-month period ended March 31, 2016, to fund the exit costs and other final cash requirements for dissolving the joint venture. The additional funding did not materially differ from the exit costs recorded as of December 31, 2015. Legal dissolution of TIORCO is finalized.

17. ACQUISITION

On June 15, 2015, the Company acquired Procter & Gamble do Brasil S.A.'s sulfonation production facility in Bahia, Brazil for cash of \$5,133,000. The facility, which is located in northeastern Brazil, has 30,000 metric tons of

surfactants capacity. The acquisition was accounted for as a business combination and, accordingly, the assets acquired and liabilities assumed as part of the acquisition were measured and recorded at their estimated fair values. The purchase included property, plant and equipment valued at \$6,007,000 and the assumption of liabilities valued at \$874,000. No intangibles or goodwill were acquired in the business combination. The purchase price allocation is final, and no allocation adjustments were made to the amounts recorded at the acquisition date. Other acquisition-related expenses were not material. The acquired business is included in the Company's Surfactants segment.

18. RECENT ACCOUNTING PRONOUNCEMENTS

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers (Topic 606). The new update was later amended by ASU No. 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date. The standard outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. In addition, the ASU requires expanded disclosures about revenue recognition that enable the users of the financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. ASU No. 2014-09 supersedes most of the previous revenue recognition guidance. For public entities, the new guidance, as amended, is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. An entity may use either a

full retrospective or a modified retrospective approach to adopt the requirements of the new standard. The Company continues the process of determining the effects, if any, that adoption of ASU No. 2014-09 will have on Company financial position, results of operations and cash flows.

In January 2015, the FASB issued ASU No. 2015-01, Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items, which amends Subtopic 225-20, Income Statement – Extraordinary and Unusual Items, of the Accounting Standards Codification. The update, which is part of FASB's initiative to reduce complexity of accounting standards, eliminates the US GAAP concept of extraordinary items. The amendments in this update were effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. Adoption of this ASU did not have an effect on the Company's financial position, results of operations or cash flows.

In February 2015, the FASB issued ASU No. 2015-02, Consolidation (Topic 810): Amendments to the Consolidation Analysis. The amendments in this update affect reporting entities that are required to evaluate whether they should consolidate certain legal entities. All legal entities are subject to reevaluation under the revised consolidation model. Specifically, the amendments: 1) modify the evaluation of whether limited partnerships and similar legal entities are variable interest entities (VIEs) or voting interest entities; 2) eliminate the presumption that a general partner should consolidate a limited partnership; 3) affect the consolidation analysis of reporting entities that are involved with VIEs, particularly those that have fee arrangements and related party relationships; and 4) provide a scope exception from consolidation guidance for reporting entities with interests in legal entities that are required to comply with or operate in accordance with certain Investment Company Act of 1940 requirements for registered money market funds. The amendments in ASU No. 2015-02 were effective for public business entities for fiscal years, and for interim periods within those fiscal years, beginning after December 15, 2015. Adoption of ASU No. 2015-02 did not have an effect on the Company's financial position, results of operations or cash flows.

In April 2015, the FASB issued ASU No. 2015-03, Interest – Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs. The amendments in this update change the presentation of debt issuance costs in financial statements. Under this ASU, an entity is required to present debt issuance costs in the balance sheet as a direct deduction from the related debt liability rather than as an asset. Amortization of the costs is to be reported as interest expense, which is where the Company has historically reported such costs. The guidance in ASU No. 2015-03 was effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. The new guidance was to be applied retrospectively to all prior periods. Therefore, upon adoption of ASU No. 2015-03 on January 1, 2016, the Company reclassified \$1,269,000 of its unamortized debt issuance costs at December 31, 2015, from the other non-current assets line of the consolidated balance sheet to the long-term debt, less current maturities line (see Note 12). Other than the reclassification of unamortized debt issuance costs, the adoption of ASU No. 2015-03 did not have an effect on the Company's consolidated financial statements.

In August 2015, the FASB issued ASU No. 2015-15, Interest—Imputation of Interest (Subtopic 835-30): Presentation and Subsequent Measurement of Debt Issuance Costs Associated with Line-of-Credit Arrangements—Amendments to SEC Paragraphs Pursuant to Staff Announcement at June 18, 2015 EITF Meeting (SEC Update which) that sets forth additional guidance from the SEC regarding debt issuance costs associated with line-of-credit arrangements, which ASU No. 2015-03 does not address. The SEC has stated that given the absence of authoritative guidance for debt issuance costs related to line-of-credit arrangements, the SEC staff would not object to an entity deferring and presenting debt issuance costs as an asset and subsequently amortizing the deferred debt issuance costs ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement. Since the Company's treatment of debt issuance costs associated with line-of-credit arrangements aligned with the SEC's guidance, adoption of ASU 2015-15 did not have an effect on the Company's financial position, results of operations or cash flows.

In April 2015, the FASB issued ASU No. 2015-05, Intangibles - Goodwill and Other – Internal-Use Software (Subtopic 350-40): Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement. This ASU provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The amendments in ASU No. 2015-05 were effective for annual periods, including interim periods within those annual periods, beginning after December 15, 2015. Adoption of ASU No. 2015-05 did not have an effect on the Company’s financial position, results of operations and cash flows.

In July 2015, the FASB issued ASU No. 2015-11, Inventory (Topic 330), Simplifying the Measurement of Inventory, which requires an entity to measure inventory within the scope of the update at the lower of cost and net realizable value. Prior guidance required inventory to be measured at the lower of cost or market. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. Subsequent measurement is unchanged for inventory measured using LIFO or the retail inventory method. For public entities, ASU No. 2015-11 is effective prospectively for annual periods beginning after December 15, 2016, and interim periods therein. Early

adoption is permitted. Adoption of ASU No. 2015-11 is not expected to have a material effect on the Company's financial position, results of operations or cash flows.

In September 2015, the FASB issued ASU No. 2015-16, Business Combinations (Topic 805), Simplifying the Accounting for Measurement-Period Adjustments. The update requires that the acquirer in a business combination recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined (not retrospectively as with prior guidance). Additionally, the acquirer must record in the same period's financial statements the effect on earnings of changes in depreciation, amortization or other income effects as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the time of acquisition. The acquiring entity is required to disclose, on the face of the financial statements or in the footnotes to the financial statements, the portion of the amount recorded in current period earnings, by financial statement line item, that would have been recorded in previous reporting periods if the adjustment to the provisional amounts had been recognized as of the acquisition date. The guidance in ASU No. 2015-16 was effective for fiscal years beginning after December 15, 2015, including interim periods within those fiscal years. Adoption of ASU No. 2015-16 did not have an effect on the Company's financial position, results of operations or cash flows.

In February 2016, the FASB issued ASU No. 2016-2, Leases (Topic 842). This guidance requires a dual approach for lessee accounting whereby a lessee will account for lease arrangements with terms greater than 12 months as either finance leases or operating leases. Both finance leases and operating leases will be recognized on the lessee's balance sheet as right-of-use assets and corresponding lease liabilities, with differing methodologies for income statement recognition. In addition, the ASU requires expanded qualitative and quantitative disclosures about the Company's lease arrangements. This guidance is effective for public business entities for fiscal years, and interim periods within those years, beginning after December 15, 2018. Early adoption is permitted. A modified retrospective approach is required for all leases existing or entered into after the beginning of the earliest comparative period in the consolidated financial statements. The Company is assessing the impact that adoption of ASU No. 2016-2 will have on its financial position, results of operations and cash flows.

In March 2016, the FASB issued ASU No. 2016-9, Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. The ASU was issued to simplify various facets of the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures and statutory tax withholding requirements. The new guidance also addresses the classifications of certain share-based payment transactions in the statement of cash flows. For public business entities, ASU No. 2016-9 is effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted, but all of the amendments in the update must be adopted in the same period. The Company is assessing the impact that adoption of ASU No. 2016-9 will have on its financial position, results of operations and cash flows.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses on Financial Statements, which amends the guidance for the impairment of financial instruments and is expected to result in more timely recognition of impairment losses. The update introduces an impairment model referred to as the current expected credit loss (CECL) model. The impairment model is based on expected losses rather than incurred losses. Under the new guidance, an entity recognizes as an allowance its estimate of expected credit losses. The ASU is also intended to reduce the complexity of the current guidance by decreasing the number of credit impairment models that entities use to account for debt instruments. For public business entities that are SEC filers, the amendments in ASU No. 2016-13 are effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Entities may adopt the amendments in this update earlier as of the fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. The Company is assessing the impact that adoption of ASU No. 2016-13 will have on its financial position, results of operations and cash flows.

19. SUBSEQUENT EVENT

On July 20, 2016, the Company reported that its subsidiary in Brazil reached an agreement with Tebras Tensoativos do Brazil Ltda. (Tebras) to acquire their commercial business and with PBC Industria Quimica Ltda. (PBC) to acquire their sulfonation production facility. The combined entities have annual sales of approximately \$32,000,000 dollars, 25,000 metric tons of sulfonation capacity and a large, diverse customer portfolio. The transaction is subject to customary closing conditions and is projected to close in the fourth quarter of 2016. The acquisition of Tebras and PBC, which will be included in the Company's Surfactants segment, is expected to expand and diversify the Company's customer base for sulfonated products in Brazil and to provide an opportunity to sell the Company's broader surfactant portfolio to over 1,200 new customers who will benefit from the Company's technical service and formulation support. The transaction is expected to have minimal impact on the Company's 2016 financial results.

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

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

Certain matters discussed in the MD&A include forward-looking statements that are subject to certain risks, uncertainties and assumptions. Such forward-looking statements are intended to be identified in this document by the words, "anticipate," "believe," "estimate," "expect," "intend," "may," "objective," "outlook," "plan," "project," "possible," "potential" and similar expressions. Actual results may vary materially.

Forward-looking statements speak only as of the date they are made, and the Company does not undertake any obligation to update them to reflect changes that occur after that date. Factors that could cause actual results to differ materially include the items described in Item 1A of the Company's Annual Report on Form 10-K for the year ended December 31, 2015.

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 67 percent of consolidated net sales for the first half of 2016, are principal ingredients in consumer and industrial cleaning products such as detergents for washing clothes, dishes, carpets, floors and walls, as well as shampoos and body washes. Other applications include fabric softeners, germicidal quaternary compounds, lubricating ingredients, emulsifiers for spreading agricultural products and industrial applications such as latex systems, plastics and composites. 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), four Latin American sites (Mexico, Colombia and two sites in Brazil) and two Asian sites (Philippines and Singapore). The Company announced plans to shut down its production facility in Canada by the end of 2016. See the 'Business Restructuring' discussion that follows for additional information about the plant closure. Prior to 2016, the Company also held a 50 percent ownership interest in a joint venture, TIORCO, LLC (TIORCO), that marketed chemical solutions for enhanced oil recovery (EOR). The joint venture was accounted for under the equity method, and its financial results were excluded from surfactant segment operating results. In October 2015, the Company and its partner, Nalco Company (a subsidiary of Ecolab Inc.), made the decision to dissolve TIORCO. No business activities have been conducted since the fourth quarter of 2015. Legal dissolution of TIORCO is finalized.
- **Polymers** – Polymers, which accounted for 28 percent of consolidated net sales for the first half of 2016, include polyurethane polyols, polyester resins and phthalic anhydride. Polyurethane polyols are used in the manufacture of rigid foam 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. Polyester resins, which include liquid and powdered products, are used in CASE and polyurethane systems house applications. CASE, polyester resins and flexible foam are collectively referred to as specialty polyols. 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., polyurethane polyols and phthalic anhydride are manufactured at the Company's Millsdale, Illinois, site and specialty polyols are manufactured at the Company's Columbus, Georgia, site. In Europe, polyurethane polyols are manufactured at the Company's subsidiary in Germany, and specialty polyols are manufactured at the Company's Poland subsidiary. In China, polyols and specialty polyols are manufactured at the

recently constructed and commissioned plant in Nanjing, China.

· Specialty Products – Specialty products, which accounted for five percent of consolidated net sales for the first half of 2016, include flavors, emulsifiers and solubilizers used in food, flavoring, nutritional supplement and pharmaceutical applications. Specialty products are primarily manufactured at the Company's Maywood, New Jersey, site and, in some instances, at outside contractors.

Business Restructuring

In May 2016, the Company announced plans to shut down its Longford Mills, Canada, facility, a part of the Surfactants reportable segment, by the end of 2016. Execution of this plan will result in a workforce reduction of approximately 30 employees. Production of goods currently manufactured at the Longford Mill's facility will be moved to other Company North American production sites. The plant closure is expected to enable the Company to improve its asset utilization in North America and to further reduce the Company's fixed cost base. For the three and six months ended June 30, 2016, the Company recognized \$1.1 million of restructuring expenses, all of which related to employee termination costs. Additional plant closure costs, including decommissioning, are estimated to be \$3.0 million and are expected to be recognized as incurred in the final half of 2016. Earlier in the year, the Company announced the discontinuation of ethoxylation production at the site in the first quarter of 2016.

In addition to the restructuring costs, the Company reduced the useful lives of the manufacturing assets in the Longford Mills plant. As a result, the Company recognized \$0.8 million and \$1.9 million of additional depreciation expense for the three and six months ended June 30, 2016, respectively (including first quarter depreciation of \$1.1 million related to the ethoxylation assets). The expense was included in the cost of sales line of the consolidated statements of income. The change in the useful lives of the assets will add about \$2.6 million of depreciation expense in the second half of 2016.

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 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 Three Months Ended June 30			Change	(1)
	2016	2015			
Deferred Compensation (Operating expenses)	\$(2.4)	\$(6.6)	\$ 4.2		
Realized/Unrealized Gains (Losses) on Investments (Other, net)	0.1	0.1	—		
Investment Income (Other, net)	—	—	—		
Pretax Income Effect	\$(2.3)	\$(6.5)	\$ 4.2		
	Income (Expense)				

For the Six
Months

(In millions)	Ended June		
	2016	2015	Change
Deferred Compensation (Operating expenses)	\$(5.2)	\$(8.2)	\$ 3.0 ⁽¹⁾
Realized/Unrealized Gains (Losses) on Investments (Other, net)	(0.2)	0.6	(0.8)
Investment Income (Other, net)	0.2	0.1	0.1
Pretax Income Effect	\$(5.2)	\$(7.5)	\$ 2.3

⁽¹⁾See the applicable Corporate Expenses section of this MD&A for details regarding the quarter-over-quarter change in deferred compensation expense.

Effects of Foreign Currency Translation

The Company's foreign subsidiaries transact business and report financial results in their respective local currencies. As a result, foreign subsidiary income statements are translated into U.S. dollars at average foreign exchange rates appropriate for the reporting period. Because foreign exchange rates fluctuate against the U.S. dollar over time, foreign currency translation affects period-to-period comparisons of financial statement items (i.e., because foreign exchange rates fluctuate, similar period-to-period local currency results for a foreign subsidiary may translate into different U.S. dollar results). The following table presents the effects that foreign currency translation had on the period-over-period changes in consolidated net sales and various income line items for the three and six months ended June 30, 2016 and 2015: