STEPAN CO
Form 10-Q
October 28, 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 SEPTEMBER 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 of incorporation or organization)	(I.R.S. Employer Identification Number)

Edens and Winnetka Road, Northfield, Illinois 60093

(Address of principal executive offices)

Registrant's telephone number (847) 446-7500

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

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

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

(Check one): Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company

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

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

Class	Outstanding at October 24, 2016
Common Stock, $1 par value	22,404,562 Shares

Part I FINANCIAL INFORMATION

Item 1 - Financial Statements

STEPAN COMPANY

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

Unaudited

(In thousands, except per share amounts)	Three Months Ended September 30		Nine Months Ended September 30	
	2016	2015	2016	2015
Net Sales	$445,030	$444,011	$1,345,530	$1,356,876
Cost of Sales	361,635	366,413	1,075,705	1,123,324
Gross Profit	83,395	77,598	269,825	233,552
Operating Expenses:				
Selling	13,990	14,025	42,252	41,287
Administrative [a]	18,958	19,076	55,350	54,320
Research, development and technical services	14,268	12,625	42,306	37,012
Deferred compensation expense (income) [a]	7,441	(6,922)	12,595	1,228
	54,657	38,804	152,503	133,847
Gain on sale of product line	—	—	—	2,862
Business restructuring	—	—	(1,061)	—
Operating Income	28,738	38,794	116,261	102,567
Other Income (Expense):				
Interest, net	(2,824)	(3,837)	(9,855)	(10,760)
Loss from equity in joint ventures (Note 16)	—	(863)	—	(3,918)
Other, net (Note 13)	1,229	(981)	401	(94)
	(1,595)	(5,681)	(9,454)	(14,772)
Income Before Provision for Income Taxes	27,143	33,113	106,807	87,795
Provision for Income Taxes	6,711	8,179	30,848	24,634
Net Income	20,432	24,934	75,959	63,161
Net Income Attributable to Noncontrolling Interests (Note 2)	(5)	(22)	(13)	(65)
Net Income Attributable to Stepan Company	$20,427	$24,912	$75,946	$63,096
Net Income Per Common Share Attributable to Stepan Company (Note 9):				
Basic	$0.90	$1.10	$3.34	$2.78
Diluted	$0.89	$1.09	$3.31	$2.76

Shares Used to Compute Net Income Per Common Share Attributable to Stepan Company (Note 9):				
Basic	22,819	22,732	22,771	22,731
Diluted	23,082	22,853	22,975	22,851
Dividends Declared Per Common Share	$0.19	$0.18	$0.57	$0.54

(a) For the three and nine months ended September 30, 2015, deferred compensation expense (income) 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

(In thousands)	Three Months Ended September 30 2016	Three Months Ended September 30 2015	Nine Months Ended September 30 2016	Nine Months Ended September 30 2015
Net income	$20,432	$24,934	$75,959	$63,161
Other comprehensive income (loss):				
Foreign currency translation adjustments (Note 10)	(2,213)	(19,793)	7,685	(38,988)
Pension liability adjustment, net of tax (Note 10)	497	722	1,626	2,221
Derivative instrument activity, net of tax (Note 10)	—	(14)	(27)	(40)
Other comprehensive income (loss)	(1,716)	(19,085)	9,284	(36,807)
Comprehensive income	18,716	5,849	85,243	26,354
Comprehensive (income) loss attributable to noncontrolling interests (Note 2)	(1)	21	24	(24)
Comprehensive income attributable to Stepan Company	$18,715	$5,870	$85,267	$26,330

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)	September 30, 2016	December 31, 2015
Assets		
Current Assets:		
Cash and cash equivalents	$207,000	$176,143
Receivables, net	281,130	249,602
Inventories (Note 6)	184,012	170,424
Other current assets	24,190	23,404
Total current assets	696,332	619,573
Property, Plant and Equipment:		
Cost	1,502,133	1,446,098
Less: accumulated depreciation	(928,435)	(890,635)
Property, plant and equipment, net	573,698	555,463
Goodwill, net	11,284	11,265
Other intangible assets, net	15,910	17,957
Long-term investments (Note 3)	23,162	20,910
Other non-current assets (Note 18)	10,704	13,224
Total assets	$1,331,090	$1,238,392
Liabilities and Equity		
Current Liabilities:		
Current maturities of long-term debt (Note 12)	$19,669	$18,806
Accounts payable	129,089	128,605
Accrued liabilities	95,965	95,833
Total current liabilities	244,723	243,244
Deferred income taxes	13,187	9,455
Long-term debt, less current maturities (Note 12 and 18)	306,478	312,548
Other non-current liabilities	126,970	114,761
Commitments and Contingencies (Note 7)		
Equity:		
Common stock, $1 par value; authorized 60,000,000 shares; Issued shares 25,872,667 in 2016 and 25,709,391 shares in 2015	25,873	25,709
Additional paid-in capital	155,766	144,601
Accumulated other comprehensive loss (Note 10)	(115,767)	(125,088)
Retained earnings	643,422	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	638,356	556,984
Noncontrolling interests (Note 2)	1,376	1,400
Total equity	639,732	558,384
Total liabilities and equity	$1,331,090	$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)	Nine Months Ended September 30 2016	2015
Cash Flows From Operating Activities		
Net income	$75,959	$63,161
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	55,196	49,653
Deferred compensation	12,595	1,228
Realized and unrealized (gains) losses on long-term investments	(720)	293
Stock-based compensation	8,055	2,961
Deferred income taxes	4,169	107
Other non-cash items	2,120	1,867
Changes in assets and liabilities:		
Receivables, net	(30,270)	(10,338)
Inventories	(12,485)	(5,515)
Other current assets	(308)	(1,572)
Accounts payable and accrued liabilities	5,142	23,946
Pension liabilities	415	576
Environmental and legal liabilities	498	(1,503)
Deferred revenues	(846)	(1,063)
Excess tax benefit from stock options and awards	(1,828)	(260)
Net Cash Provided By Operating Activities	117,692	123,541
Cash Flows From Investing Activities		
Expenditures for property, plant and equipment	(69,761)	(90,328)
Business acquisition (Note 17)	—	(5,133)
Proceeds from sale of product line (Note14)	—	3,262
Other, net	(2,788)	(3,578)
Net Cash Used In Investing Activities	(72,549)	(95,777)
Cash Flows From Financing Activities		
Term loan	—	100,000
Revolving debt and bank overdrafts, net	1,014	(23,656)
Other debt repayments	(6,193)	(7,228)
Dividends paid	(12,732)	(12,067)
Company stock repurchased	(2,408)	(2,000)
Stock option exercises	3,290	431
Excess tax benefit from stock options and awards	1,828	260
Other, net	(275)	(673)
Net Cash (Used In) Provided By Financing Activities	(15,476)	55,067
Effect of Exchange Rate Changes on Cash	1,190	(7,589)
Net Increase in Cash and Cash Equivalents	30,857	75,242
Cash and Cash Equivalents at Beginning of Period	176,143	85,215

Cash and Cash Equivalents at End of Period	$207,000	$160,457
Supplemental Cash Flow Information		
Cash payments of income taxes, net of refunds	$18,577	$12,560
Cash payments of interest	$9,592	$6,381

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

STEPAN COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

September 30, 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 September 30, 2016, results of operations for the three and nine months ended September 30, 2016 and 2015, and cash flows for the nine months ended September 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 Annual Report on Form 10-K.

2. RECONCILIATIONS OF EQUITY

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

(In thousands)	Total Equity	Stepan Company Equity	Noncontrolling Interests’ Equity [3]
Balance at January 1, 2016	558,384	$556,984	$ 1,400
Net income	75,959	75,946	13
Dividends	(12,732)	(12,732)	—
Common stock purchases [1]	(2,643)	(2,643)	—
Stock option exercises	3,290	3,290	—
Defined benefit pension adjustments, net of tax	1,626	1,626	—
Translation adjustments	7,685	7,722	(37)
Derivative instrument activity, net of tax	(27)	(27)	—
Other [2]	8,190	8,190	—
Balance at September 30, 2016	$639,732	$638,356	$ 1,376

(In thousands)	Total Equity	Stepan Company Equity	Noncontrolling Interests' Equity [3]
Balance at January 1, 2015	$536,944	$535,546	$ 1,398
Net income	63,161	63,096	65
Dividends	(12,067)	(12,067)	—
Common stock purchases [1]	(2,273)	(2,273)	—
Stock option exercises	431	431	—
Defined benefit pension adjustments, net of tax	2,221	2,221	—
Translation adjustments	(38,988)	(38,947)	(41)
Derivative instrument activity, net of tax	(40)	(40)	—
Other [2]	3,617	3,617	—
Balance at September 30, 2015	$553,006	$551,584	$ 1,422

(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 September 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 guidance 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 September 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 presented without regard to unamortized debt issuance costs of $1,193,000 and $1,269,000 as of September 30, 2016 and December 31, 2015, respectively):

	September 30,	December 31,
(In thousands)	2016	2015
Fair value	$ 337,956	$ 331,183
Carrying value	327,340	332,623

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

(In thousands)	September 2016	Level 1	Level 2	Level 3
Mutual fund assets	$ 23,162	$23,162	$—	$ —
Derivative assets:				
Foreign currency contracts	450	—	450	—
Total assets at fair value	$ 23,612	$23,162	$450	$ —
Derivative liabilities:				
Foreign currency contracts	$ 388	$—	$388	$ —
Interest rate contracts	82	—	82	—
Total liabilities at fair value	$ 470	$—	$470	$ —

(In thousands)	December 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 September 30, 2016, and December 31, 2015, the Company had open forward foreign currency exchange contracts, all with durations of one to three months, to buy or sell foreign currencies with U.S. dollar equivalent amounts of $35,174,819 and $31,194,000, respectively.

The Company is exposed to volatility in short-term interest rates. The interest rate risk is partially mitigated by the periodic use of interest rate swaps on certain debt instruments. 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 $3,373,060 at September 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 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 September 30, 2016, and December 31, 2015, are disclosed in Note 3. Derivative instrument gains and losses for the three- and nine-month periods ended September 30, 2016 and 2015, were immaterial. For amounts reclassified out of AOCI into earnings for the three- and nine-month periods ended September 30, 2016 and 2015, see Note 10.

5. STOCK-BASED COMPENSATION

On September 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 (income) recorded for all stock options, stock awards and SARs was as follows:

(In thousands)			
Three Months Ended		Nine Months Ended	
September 30		September 30	
2016	2015	2016	2015
$3,607	$(201)	$8,055	$2,961

The increases in stock-based compensation expense between the three-month and nine-month periods ended September 30, 2016 and 2015 were primarily attributable to compensation related to cash-settled SARs and performance awards. Increases in the fair values of cash-settled SARs, driven by a significant rise in Company common stock prices, led to higher SARs compensation expense. The increased expense for performance awards resulted from management’s assessment that the profitability metrics for certain grants would be achieved at greater levels than previously estimated.

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

(In thousands)	September 30, 2016	December 31, 2015
Stock options	$ 1,239	$ 784
Stock awards	5,012	3,396
SARs	2,563	1,644

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

	Shares
Stock options	103,709
Stock awards (at target)	74,279
SARs	215,288

The unrecognized compensation costs at September 30, 2016 are expected to be recognized over weighted-average periods of 1.2 years, 1.9 years and 1.2 years for stock options, stock awards and SARs, respectively.

6. INVENTORIES

The composition of inventories was as follows:

(In thousands)	September 30, 2016	December 31, 2015
Finished goods	$ 132,904	$ 124,481
Raw materials	51,108	45,943
Total inventories	$ 184,012	$ 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 $26,235,000 and $18,171,000 higher than reported at September 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. 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 September 30, 2016, the Company estimated a range of possible environmental and legal losses of $21.4 million to $42.4 million. At September 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 $21.4 million and $20.9 million, respectively. During the first nine months of 2016 and 2015, cash outlays related to legal and environmental matters approximated $1.0 and $2.3 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 September 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 claims 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

	UNITED STATES			
	Three Months Ended		Nine Months Ended	
(In thousands)	September 30		September 30	
	2016	2015	2016	2015
Interest cost	$1,741	$1,708	$5,200	$5,111
Expected return on plan assets	(2,251)	(2,398)	(6,759)	(7,184)
Amortization of net actuarial loss	776	1,103	2,540	3,401
Net periodic benefit cost	$266	$413	$981	$1,328

	UNITED KINGDOM			
	Three Months Ended		Nine Months Ended	
(In thousands)	September 30		September 30	
	2016	2015	2016	2015
Interest cost	$177	$200	$564	$593
Expected return on plan assets	(218)	(268)	(694)	(795)
Amortization of net actuarial loss	18	46	58	137
Net periodic benefit (income) cost	$(23)	$(22)	$(72)	$(65)

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. Of such amount, as of September 30, 2016, $156,000 had been paid related to the non-qualified plans in 2016.

U.K. Plan

The Company's United Kingdom subsidiary expects to contribute approximately $380,000 to its defined benefit pension plan in 2016. Of such amount, as of September 30, 2016, $300,000 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:

(In thousands)	Three Months Ended September 30		Nine Months Ended September 30	
	2016	2015	2016	2015
Retirement savings plans	$1,304	$1,151	$3,849	$3,471
Profit sharing plan	1,595	1,377	5,098	3,568
Total defined contribution expense	$2,899	$2,528	$8,947	$7,039

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 September 30, 2016, the balance of the trust assets was $1,853,000, 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 nine months ended September 30, 2016 and 2015:

(In thousands, except per share amounts)	Three Months Ended September 30		Nine Months Ended September 30	
	2016	2015	2016	2015
Computation of Basic Earnings per Share				
Net income attributable to Stepan Company	$20,427	$24,912	$75,946	$63,096
Weighted-average number of common shares outstanding	22,819	22,732	22,771	22,731
Basic earnings per share	$0.90	$1.10	$3.34	$2.78

Computation of Diluted Earnings per Share				
Net income attributable to Stepan Company	$20,427	$24,912	$75,946	$63,096
Weighted-average number of shares outstanding	22,819	22,732	22,771	22,731
Add weighted-average net shares issuable from assumed exercise of options (under treasury stock method) [1]	134	119	124	117
Add weighted-average net shares related to unvested stock awards (under treasury stock method)	6	2	5	3
Add weighted-average net shares from assumed exercise of SARS (under treasury stock method)	73	—	40	—
Add weighted-average contingently issuable net shares related to performance stock awards (under treasury stock method)	50	—	35	—
Weighted-average shares applicable to diluted earnings	23,082	22,853	22,975	22,851
Diluted earnings per share	$0.89	$1.09	$3.31	$2.76

[1] Options to purchase 58,287 shares of Company common stock were excluded from the computations of diluted earnings per share for the nine months ended September 30, 2016. Options to purchase 90,734 and 136,170 shares of Company common stock were excluded from the computations of diluted earnings per share for the three and nine months ended September 30, 2015, respectively. The excluded 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 nine months ended September 30, 2015 and 2016:

(In thousands)	Foreign Currency Translation Adjustments	Defined Benefit Pension Plan Adjustments	Cash Flow Hedge Adjustments	Total
Balance at June 30, 2015	$ (62,111)	$ (39,650)	$ 92	$(101,669)
Other comprehensive income before reclassifications	(19,750)	—	(16)	(19,766)
Amounts reclassified from AOCI	—	722	2	724
Net current-period other comprehensive income	(19,750)	722	(14)	(19,042)
Balance at September 30, 2015	$ (81,861)	$ (38,928)	$ 78	$(120,711)
Balance at June 30, 2016	$ (78,406)	$ (35,696)	$ 47	$(114,055)
Other comprehensive income before reclassifications	(2,209)	—	(2)	(2,211)
Amounts reclassified from AOCI	—	497	2	499
Net current-period other comprehensive income	(2,209)	497	—	(1,712)
Balance at September 30, 2016	$ (80,615)	$ (35,199)	$ 47	$(115,767)
Balance at December 31, 2014	$ (42,914)	$ (41,149)	$ 118	$(83,945)
Other comprehensive income before reclassifications	(38,947)	—	(43)	$(38,990)
Amounts reclassified from AOCI	—	2,221		