

STEPAN CO
Form 10-Q
April 30, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(MARK ONE)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2014

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

1-4462

Commission File Number

STEPAN COMPANY

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)
Edens and Winnetka Road, Northfield, Illinois 60093
(Address of principal executive offices)

36-1823834
(I.R.S. Employer
Identification Number)

Registrant's telephone number (847) 446-7500

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

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

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

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

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

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

| Class | Outstanding at April 29, 2014 |
|-----------------------------|--------------------------------------|
| Common Stock, \$1 par value | 22,365,961 Shares |

Part I FINANCIAL INFORMATION**Item 1 Financial Statements**

STEPAN COMPANY

CONDENSED CONSOLIDATED STATEMENTS OF INCOME

Unaudited

| <i>(In thousands, except per share amounts)</i> | Three Months Ended | |
|---|--------------------|------------------|
| | March 31 | |
| | 2014 | 2013 |
| Net Sales | \$ 477,442 | \$ 456,546 |
| Cost of Sales | 414,418 | 383,846 |
| Gross Profit | 63,024 | 72,700 |
| Operating Expenses: | | |
| Selling | 14,146 | 13,728 |
| Administrative | 14,431 | 19,351 |
| Research, development and technical services | 11,924 | 11,327 |
| | 40,501 | 44,406 |
| Operating Income | 22,523 | 28,294 |
| Other Income (Expense): | | |
| Interest, net | (2,957) | (2,179) |
| Loss from equity in joint ventures | (1,451) | (1,413) |
| Other, net (Note 13) | (26) | 571 |
| | (4,434) | (3,021) |
| Income Before Provision for Income Taxes | 18,089 | 25,273 |
| Provision for Income Taxes | 5,081 | 6,276 |
| Net Income | 13,008 | 18,997 |
| Net Loss Attributable to Noncontrolling Interests (Note 2) | 10 | 37 |
| Net Income Attributable to Stepan Company | \$ 13,018 | \$ 19,034 |
| Net Income Per Common Share Attributable to Stepan Company (Note 9): | | |
| Basic | \$ 0.57 | \$ 0.85 |
| Diluted | \$ 0.57 | \$ 0.83 |
| Shares Used to Compute Net Income Per Common Share Attributable to Stepan Company (Note 9): | | |

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| | | |
|-------------------------------------|---------|---------|
| Basic | 22,773 | 22,464 |
| Diluted | 22,964 | 22,887 |
| Dividends Declared Per Common Share | \$ 0.17 | \$ 0.16 |

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

STEPAN COMPANY

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Unaudited

| <i>(In thousands)</i> | Three Months Ended March 31 | |
|--|-----------------------------------|-----------|
| | 2014 | 2013 |
| Net income | \$ 13,008 | \$ 18,997 |
| Other comprehensive income (loss): | | |
| Foreign currency translation adjustments (Note 10) | 94 | (4,416) |
| Pension liability adjustment, net of tax (Note 10) | 410 | 863 |
| Derivative instrument activity, net of tax (Note 10) | 3 | (12) |
| Other comprehensive income (loss) | 507 | (3,565) |
| Comprehensive income | 13,515 | 15,432 |
| Comprehensive loss attributable to noncontrolling interests (Note 2) | 33 | 35 |
| Comprehensive income attributable to Stepan Company | \$ 13,548 | \$ 15,467 |

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

STEPAN COMPANY
CONDENSED CONSOLIDATED BALANCE SHEETS

Unaudited

| <i>(In thousands)</i> | March 31, 2014 | December 31, 2013 |
|---|------------------|-------------------|
| Assets | | |
| Current Assets: | | |
| Cash and cash equivalents | \$ 96,720 | \$ 133,347 |
| Receivables, net | 296,279 | 265,721 |
| Inventories (Note 6) | 185,637 | 172,368 |
| Deferred income taxes | 12,070 | 12,637 |
| Other current assets | 22,779 | 24,477 |
| Total current assets | 613,485 | 608,550 |
| Property, Plant and Equipment: | | |
| Cost | 1,331,639 | 1,316,499 |
| Less: accumulated depreciation | 836,516 | 822,457 |
| Property, plant and equipment, net | 495,123 | 494,042 |
| Goodwill, net | 11,694 | 11,726 |
| Other intangible assets, net | 22,950 | 23,669 |
| Long-term investments (Note 3) | 18,992 | 18,305 |
| Other non-current assets | 12,289 | 10,910 |
| Total assets | \$ 1,174,533 | \$ 1,167,202 |
| Liabilities and Equity | | |
| Current Liabilities: | | |
| Current maturities of long-term debt (Note 12) | \$ 35,074 | \$ 35,377 |
| Accounts payable | 167,845 | 157,277 |
| Accrued liabilities | 66,243 | 76,339 |
| Total current liabilities | 269,162 | 268,993 |
| Deferred income taxes | 18,935 | 20,616 |
| Long-term debt, less current maturities (Note 12) | 234,565 | 235,246 |
| Other non-current liabilities | 87,576 | 88,606 |
| Commitments and Contingencies (Note 7) | | |
| Equity: | | |

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| | | |
|--|--------------|--------------|
| Common stock, \$1 par value; authorized 30,000,000 shares; issued 25,601,713 shares in 2014 and 25,563,909 shares in 2013 | 25,602 | 25,564 |
| Additional paid-in capital | 136,994 | 135,693 |
| Accumulated other comprehensive loss (Note 10) | (28,998) | (29,528) |
| Retained earnings | 488,044 | 478,826 |
| Less: Common treasury stock, at cost, 3,238,321 shares in 2014 and 3,231,289 shares in 2013 | (58,769) | (58,269) |
| Total Stepan Company stockholders equity | 562,873 | 552,286 |
| Noncontrolling interests (Note 2) | 1,422 | 1,455 |
| Total equity | 564,295 | 553,741 |
| Total liabilities and equity | \$ 1,174,533 | \$ 1,167,202 |

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

STEPAN COMPANY

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

Unaudited

| <i>(In thousands)</i> | Three Months Ended March 31 | |
|---|-----------------------------|-----------------|
| | 2014 | 2013 |
| Cash Flows From Operating Activities | | |
| Net income | \$ 13,008 | \$ 18,997 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 16,098 | 13,419 |
| Deferred compensation | (248) | 4,933 |
| Realized and unrealized gain on long-term investments | (23) | (898) |
| Stock-based compensation | 226 | (219) |
| Deferred income taxes | (1,851) | (2,524) |
| Other non-cash items | 1,573 | 1,708 |
| Changes in assets and liabilities: | | |
| Receivables, net | (30,013) | (31,815) |
| Inventories | (13,245) | (16,488) |
| Other current assets | 646 | (1,097) |
| Accounts payable and accrued liabilities | 6,291 | 5,460 |
| Pension liabilities | (466) | 456 |
| Environmental and legal liabilities | (357) | (28) |
| Deferred revenues | (183) | (101) |
| Excess tax benefit from stock options and awards | (414) | (1,705) |
| Net Cash Used In Operating Activities | (8,958) | (9,902) |
| Cash Flows From Investing Activities | | |
| Expenditures for property, plant and equipment | (20,503) | (20,980) |
| Sale of mutual funds | 738 | 390 |
| Other, net | (3,362) | (2,322) |
| Net Cash Used In Investing Activities | (23,127) | (22,912) |
| Cash Flows From Financing Activities | | |
| Revolving debt and bank overdrafts, net | (311) | 17,542 |
| Other debt repayments | (688) | (5,190) |
| Dividends paid | (3,800) | (3,542) |
| Company stock repurchased | (430) | |
| Stock option exercises | 904 | 1,875 |
| Excess tax benefit from stock options and awards | 414 | 1,705 |
| Other, net | (100) | (1,059) |
| Net Cash Provided By (Used In) Financing Activities | (4,011) | 11,331 |
| Effect of Exchange Rate Changes on Cash | (531) | (622) |

| | | |
|--|-----------|-----------|
| Net Decrease in Cash and Cash Equivalents | (36,627) | (22,105) |
| Cash and Cash Equivalents at Beginning of Period | 133,347 | 76,875 |
| Cash and Cash Equivalents at End of Period | \$ 96,720 | \$ 54,770 |

Supplemental Cash Flow Information

| | | |
|---|----------|----------|
| Cash payments of income taxes, net of refunds | \$ 2,790 | \$ 2,999 |
| Cash payments of interest | \$ 463 | \$ 652 |

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

STEPAN COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2014

Unaudited

1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The condensed consolidated financial statements included herein have been prepared by Stepan Company (Company), without audit, pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations, although management believes that the disclosures are adequate and make the information presented not misleading. In the opinion of management, all adjustments, consisting only of normal recurring accruals, necessary to present fairly the Company's financial position as of March 31, 2014, and its results of operations and cash flows for the three months ended March 31, 2014 and 2013, 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 2013 Form 10-K.

2. RECONCILIATIONS OF EQUITY

Below are reconciliations of total equity, Company equity and equity attributable to noncontrolling interests for the three months ended March 31, 2014 and 2013:

| <i>(In thousands)</i> | Total Equity | Stepan Company Equity | Noncontrolling Interest Equity ⁽³⁾ |
|---|-----------------|-----------------------------|---|
| Balance at January 1, 2014 | \$ 553,741 | \$ 552,286 | \$ 1,455 |
| Net income | 13,008 | 13,018 | (10) |
| Dividends | (3,800) | (3,800) | |
| Common stock purchases ⁽¹⁾ | (531) | (531) | |
| Stock option exercises | 904 | 904 | |
| Defined benefit pension adjustments, net of tax | 410 | 410 | |
| Translation adjustments | 94 | 117 | (23) |
| Derivative instrument activity, net of tax | 3 | 3 | |
| Other ⁽²⁾ | 466 | 466 | |
| Balance at March 31, 2014 | \$ 564,295 | \$ 562,873 | \$ 1,422 |

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

- (1) Includes the value of Company shares purchased in the open market and the value of Company common shares tendered by employees to settle minimum statutory withholding taxes related to the receipt of performance awards and deferred compensation distributions.
- (2) Primarily comprised of activity related to stock-based compensation, deferred compensation and excess tax benefits.
- (3) Consists entirely of noncontrolling interest in the Company's China joint venture.

3. FAIR VALUE MEASUREMENTS

The following describe the financial instruments held by the Company at March 31, 2014, and December 31, 2013, and the methods and assumptions used to estimate the instruments' fair values:

Cash and cash equivalents

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

Derivative assets and liabilities

Derivative assets and liabilities relate to 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 are the mutual fund assets the Company holds 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 9). 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 March 31, 2014, and December 31, 2013, the fair value of debt and the related carrying values, including current maturities, were as follows:

| <i>(In thousands)</i> | March 31, 2014 | December 31, 2013 |
|-----------------------|----------------|-------------------|
| Fair value | \$ 278,231 | \$ 276,069 |
| Carrying value | 269,639 | 270,623 |

The following tables present financial assets and liabilities measured on a recurring basis at fair value as of March 31, 2014, and December 31, 2013, and the level within the fair value hierarchy in which the fair value measurements fall:

| <i>(In thousands)</i> | March | | | |
|---------------------------------|-----------|-----------|---------|---------|
| | 2014 | Level 1 | Level 2 | Level 3 |
| Mutual fund assets | \$ 18,992 | \$ 18,992 | \$ | \$ |
| Derivative assets: | | | | |
| Foreign currency contracts | 41 | | 41 | |
| Total assets at fair value | \$ 19,033 | \$ 18,992 | \$ 41 | \$ |
| Derivative liabilities: | | | | |
| Foreign currency contracts | \$ 79 | \$ | \$ 79 | \$ |
| Interest rate contracts | 13 | | 13 | |
| Total liabilities at fair value | \$ 92 | \$ | \$ 92 | \$ |

| <i>(In thousands)</i> | December | | | |
|---------------------------------|-----------|-----------|---------|---------|
| | 2013 | Level 1 | Level 2 | Level 3 |
| Mutual fund assets | \$ 18,305 | \$ 18,305 | \$ | \$ |
| Derivative assets: | | | | |
| Foreign currency contracts | 74 | | 74 | |
| Total assets at fair value | \$ 18,379 | \$ 18,305 | \$ 74 | \$ |
| Derivative liabilities : | | | | |
| Foreign currency contracts | \$ 165 | \$ | \$ 165 | \$ |
| Interest rate contracts | 20 | | 20 | |
| Total liabilities at fair value | \$ 185 | \$ | \$ 185 | \$ |

4. DERIVATIVE INSTRUMENTS

The Company is exposed to certain risks relating to its ongoing business operations. The primary risk managed by the use of derivative instruments is foreign currency exchange risk. The Company holds forward foreign currency exchange contracts that are not designated as any type of accounting hedge as defined by U.S. generally accepted accounting principles. The Company uses these contracts to manage its exposure to exchange rate fluctuations on certain Company subsidiary accounts receivable, accounts payable and other obligation balances that are denominated in currencies other than the entities' functional currencies. The forward foreign exchange contracts are recognized on the balance sheet as either an asset or a liability measured at fair value. Gains and losses arising from recording the foreign exchange contracts at fair value are reported in earnings as offsets to the losses and gains reported in earnings arising from the re-measurement of the receivable and payable balances into the applicable functional currencies. At March 31, 2014, and December 31, 2013, the Company had open forward foreign currency exchange contracts, with settlement dates of about one month, to buy or sell foreign currencies with U.S. dollar equivalent amounts of \$18,355,000 and \$20,289,000, 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 \$2,066,000 at March 31, 2014, and \$2,268,000 at December 31, 2013, which were designated as cash flow hedges. Period-to-period changes in the fair value of interest rate swap contracts are recognized as gains or losses in other comprehensive income, to the extent effective. As each interest rate swap hedge contract is settled, the corresponding gain or loss is reclassified out of 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 September 30, 2015.

The fair values of the derivative instruments held by the Company on March 31, 2014, and December 31, 2013, and derivative instrument gains and losses for the three month periods ending March 31, 2014 and 2013, were immaterial. For amounts reclassified out of AOCI into earnings for the three month periods ended March 31, 2014 and 2013, see Note 10.

5. STOCK-BASED COMPENSATION

On March 31, 2014, the Company had stock options outstanding under its 2000 Stock Option Plan, stock options and stock awards outstanding under its 2006 Incentive Compensation Plan and stock options, stock awards and stock appreciation rights (SARs) outstanding under its 2011 Incentive Compensation Plan.

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

| | |
|-----------------------------|----------|
| <i>(In thousands)</i> | |
| Three Months Ended March 31 | |
| 2014 | 2013 |
| \$226 | \$ (219) |

During the first quarters of 2014 and 2013, management assessed that the profitability performance targets on which the compensation expenses for stock awards vesting on December 31, 2014 and 2013, were based would not be achieved. For 2014, the resulting expense adjustment lowered the overall stock-based compensation expenses. For 2013, the resulting expense adjustment led to stock-based compensation income.

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

| | | |
|-----------------------|----------------|-------------------|
| <i>(In thousands)</i> | March 31, 2014 | December 31, 2013 |
| Stock options | \$ 1,614 | \$ 756 |
| Stock awards | 3,806 | 2,086 |
| SARs | 3,452 | 1,365 |

The increases in unrecognized compensation costs for stock options, stock awards and SARs reflected the first quarter 2014 grants of:

| | Shares |
|---------------|---------|
| Stock options | 50,178 |
| Stock awards | 42,494 |
| SARs | 107,850 |

The unrecognized compensation costs at March 31, 2014, are expected to be recognized over weighted-average periods of 1.6 years, 2.3 years and 1.6 years for stock options, stock awards and SARs, respectively.

6. INVENTORIES

The composition of inventories was as follows:

| <i>(In thousands)</i> | March 31, 2014 | December 31, 2013 |
|--------------------------|-------------------|-------------------|
| Finished products | \$ 125,095 | \$ 123,212 |
| Raw materials | 60,542 | 49,156 |
| Total inventories | \$ 185,637 | \$ 172,368 |

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, inventory balances would have been approximately \$32,644,000 and \$30,786,000 higher than reported at March 31, 2014, and December 31, 2013, respectively.

7. CONTINGENCIES

There are a variety of legal proceedings pending or threatened against the Company. Some of these proceedings may result in fines, penalties, judgments or costs being assessed against the Company at some future time. The Company's operations are subject to extensive local, state and federal regulations, including the U.S. Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA) and the Superfund amendments of 1986 (Superfund). Over the years, the Company has received requests for information related to or has been named by the government as a potentially responsible party (PRP) at a number of waste disposal sites where clean up costs have been or may be incurred under CERCLA and similar state statutes. In addition, damages are being claimed against the Company in general liability actions for alleged personal injury or property damage in the case of some disposal and plant sites. The Company believes that it has made adequate provisions for the costs it may incur with respect to these sites.

As of March 31, 2014, the Company estimated a range of possible environmental and legal losses of \$10.2 million to \$29.0 million. At March 31, 2014, and December 31, 2013, the Company's accrued liability for such losses, which represented the Company's

best estimate within the estimated range of possible environmental and legal losses, was \$15.2 million and \$14.7 million, respectively. During the first three months of 2014 cash outlays related to legal and environmental matters approximated \$0.3 million compared to \$0.6 million in the first three months of 2013.

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

Following are summaries of the material contingencies at March 31, 2014:

Maywood, New Jersey Site

The Company's property in Maywood, New Jersey and property formerly owned by the Company adjacent to its current site and other nearby properties (Maywood site) were listed on the National Priorities List in September 1993 pursuant to the provisions of CERCLA because of certain alleged chemical contamination. Pursuant to an Administrative Order on Consent entered into between USEPA and the Company for property formerly owned by the Company, and the issuance of an order by USEPA to the Company for property currently owned by the Company, the Company has completed various Remedial Investigation Feasibility Studies (RI/FS) and has recorded a liability based on its best estimate of the remediation costs.

On August 23, 2013, USEPA issued a Feasibility Study and a Proposed Plan selecting remedies for soil remediation which, in some cases, may be different from those the Company used in determining its best estimate. The Company submitted comments to USEPA on the Proposed Plan in December 2013. Those comments raised significant issues with both the Proposed Plan's remedy selections and cost estimates. As a result, the Proposed Plan has had no impact on the Company's recorded liability at this time. Until such time as USEPA completes its remedy selection process, the Company does not know the scope of remediation that may be required. At this time, based on its current review and analysis of the Proposed Plan, the Company's recorded liability for claims associated with remediation of chemical contamination at the Maywood site represents its best estimate of the cost of remediation for the Maywood site. The estimated cost of such remediation could differ from the Company's current recorded liability, for example, if the Proposed Plan is adopted without any changes or based on the availability of additional information.

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

D Imperio Property Site

During the mid-1970 s, Jerome Lightman and the Lightman Drum Company disposed of hazardous substances at several sites in New Jersey. The Company was named as a potentially responsible party (PRP) in the case *United States v. Lightman* (1:92-cv-4710 D.N.J.), which involved the D Imperio Property Site located in New Jersey. In 2012, the PRPs approved certain changes to remediation cost estimates which were considered in the Company s determination of its range of estimated possible losses and liability balance. The changes in range of possible losses and liability balance were immaterial. Remediation work is continuing at this site. Based on current information, the Company believes that its recorded liability for claims associated with the D Imperio site is adequate. However, actual costs could differ from current estimates.

Wilmington Site

The Company is currently contractually obligated to contribute to the response costs associated with the Company s formerly-owned site at 51 Eames Street, Wilmington, Massachusetts. Remediation at this site is being managed by its current owner to whom the Company sold the property in 1980. Under the agreement, once total site remediation costs exceed certain levels, the Company is obligated to contribute up to five percent of future response costs associated with this site with no limitation on the ultimate amount of contributions. To date, the Company has paid the current owner \$2.2 million for the Company s portion of environmental response costs through the fourth quarter of 2013 (the current owner of the site bills the Company one calendar quarter in arrears). The Company has recorded a liability for its portion of the estimated remediation costs for the site. Depending on the ultimate cost of the remediation at this site, the amount for which the Company is liable could differ from the current estimates.

The Company and other prior owners also entered into an agreement in April 2004 waiving certain statute of limitations defenses for claims which may be filed by the Town of Wilmington, Massachusetts, in connection with this site. While the Company has denied any liability for any such claims, the Company agreed to this waiver while the parties continue to discuss the resolution of any potential claim which may be filed.

The Company believes that based on current information it has adequate reserves for the claims related to this site. However, depending on the ultimate cost of the remediation at this site, the amount for which the Company is liable could differ from the current estimates.

Unclaimed Property Examination

The Company is undergoing an unclaimed property examination by Delaware (the Company's state of incorporation) and seven other states for the period covering 1981 through 2010. The types of unclaimed property under examination include certain un-cashed payroll and accounts payable checks and certain accounts receivable credits. Generally, unclaimed property must be reported and remitted to the state of the rightful owner. In cases where the rightful owner cannot be identified, the property must be reported and remitted to the unclaimed property holder's state of incorporation. The audit could result in additional liabilities being assessed against the Company. However, because the examination is in its early stages, the Company's liability, if any, is currently not determinable.

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

| <i>(In thousands)</i> | UNITED STATES | | UNITED KINGDOM | |
|------------------------------------|--------------------|----------|--------------------|--------|
| | Three Months Ended | | Three Months Ended | |
| | March 31 | | March 31 | |
| | 2014 | 2013 | 2014 | 2013 |
| Interest cost | \$ 1,723 | \$ 1,607 | \$ 243 | \$ 223 |
| Expected return on plan assets | (2,378) | (2,202) | (328) | (234) |
| Amortization of net actuarial loss | 662 | 1,306 | | 71 |
| Net periodic benefit cost (income) | \$ 7 | \$ 711 | \$ (85) | \$ 60 |

Employer Contributions***U.S. Plans***

The Company expects to contribute approximately \$1,420,000 to its funded U.S. qualified defined benefit pension plans in 2014 and to pay \$185,000 related to its unfunded unqualified plans. As of March 31, 2014, no contributions had been made to the qualified plans and \$138,000 had been paid related to the non-qualified plans.

U.K. Plan

The Company's United Kingdom subsidiary expects to contribute approximately \$1,005,000 to its defined benefit pension plan in 2014. As of March 31, 2014, \$302,000 had been contributed to the plan.

Defined Contribution Plans

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

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

| <i>(In thousands)</i> | Three Months Ended | |
|---|--------------------|-----------------|
| | March 31 | |
| | 2014 | 2013 |
| Retirement savings plans | \$ 1,131 | \$ 1,077 |
| Profit sharing plan | 764 | 1,325 |
| Total defined contribution expense | \$ 1,895 | \$ 2,402 |

The Company funds the obligations of its non-qualified supplemental executive defined contribution plans (supplemental plans) through a rabbi trust. The trust comprises various mutual fund investments selected by the participants of the supplemental plans. In accordance with the accounting guidance for rabbi trust arrangements, the assets of the trust and the obligations of the supplemental plans are reported on the Company's consolidated balance sheets. The Company elected the fair value option for the mutual fund investment assets so that offsetting changes in the mutual fund values and defined contribution plan obligations would be recorded in earnings in the same period. Therefore, the mutual funds are reported at fair value with any subsequent changes in fair value recorded in the statements of income. The liabilities related to the supplemental plans increase (i.e., supplemental plan expense is recognized) when the value of the trust assets appreciates and decrease when the value of the trust assets declines (i.e., supplemental plan income is recognized). At March 31, 2014, the balance of the trust assets was \$1,928,000, which equaled the balance of the supplemental plan liabilities (see the long-term investments section in Note 3 for further information regarding the Company's mutual fund assets).

9. EARNINGS PER SHARE

Below are the computations of basic and diluted earnings per share for the three months ended March 31, 2014 and 2013.

| | Three Months Ended March 31 | |
|--|-----------------------------------|-----------|
| <i>(In thousands, except per share amounts)</i> | 2014 | 2013 |
| <u>Computation of Basic Earnings per Share</u> | | |
| Net income attributable to Stepan Company | \$ 13,018 | \$ 19,034 |
| Deduct dividends on preferred stock ⁽¹⁾ | | 21 |
| Income applicable to common stock | \$ 13,018 | \$ 19,013 |
| Weighted-average number of shares outstanding | 22,773 | 22,464 |
| Basic earnings per share | \$ 0.57 | \$ 0.85 |
| <u>Computation of Diluted Earnings per Share</u> | | |
| Net income attributable to Stepan Company | \$ 13,018 | \$ 19,034 |
| Weighted-average number of shares outstanding | 22,773 | 22,464 |
| Add weighted-average net shares issuable from assumed exercise of options (under treasury stock method) ⁽²⁾ | 182 | 275 |
| Add weighted-average net shares related to unvested stock awards (under treasury stock method) | 9 | 7 |
| Add weighted-average shares issuable from assumed conversion of convertible preferred stock ⁽¹⁾ | | 141 |
| Weighted-average shares applicable to diluted earnings | 22,964 | 22,887 |
| Diluted earnings per share | \$ 0.57 | \$ 0.83 |

⁽¹⁾ On August 9, 2013, the Company redeemed the remaining outstanding shares of its 5 ½ percent convertible preferred stock.

⁽²⁾ Options to purchase 47,639 and 49,776 shares of Company common stock were excluded from the computation of diluted earnings per share for the three months ended March 31, 2014 and March 31, 2013, respectively. The options' exercise prices were greater than the average market price for the common stock and their effect would have been antidilutive.

10. ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)

The changes in the Company's accumulated other comprehensive income (loss) (AOCI) by component (net of income taxes) for the three month periods ended March 31, 2014 and 2013, are presented below:

| <i>(In thousands)</i> | Foreign Currency Translation Adjustments | Defined Benefit Pension Plan Adjustments | Cash Flow Hedge Adjustments | Total |
|---|---|---|--------------------------------------|-------------|
| Balance at December 31, 2012 | \$ (2,886) | \$ (35,498) | \$ 134 | \$ (38,250) |
| Other comprehensive income before reclassifications | (4,418) | | (21) | (4,439) |
| Amounts reclassified from AOCI | | 863 | 9 | 872 |
| Net current-period other comprehensive income | (4,418) | 863 | (12) | (3,567) |
| Balance at March 31, 2013 | \$ (7,304) | \$ (34,635) | \$ 122 | \$ (41,817) |
| Balance at December 31, 2013 | \$ (10,971) | \$ (18,672) | \$ 115 | \$ (29,528) |
| Other comprehensive income before reclassifications | 117 | | | 117 |
| Amounts reclassified from AOCI | | 410 | 3 | 413 |
| Net current-period other comprehensive income | 117 | 410 | 3 | 530 |
| Balance at March 31, 2014 | \$ (10,854) | \$ (18,262) | \$ 118 | \$ (28,998) |

Information regarding the reclassifications out of AOCI for the three month periods ended March 31, 2014 and 2013, is displayed below:

| <i>(In thousands)</i> AOCI Components | Amount Reclassified from AOCI (a) | | Affected Line Item in Consolidated Statements of Income |
|---|--------------------------------------|-------------------|---|
| | 2014 | 2013 | |
| Amortization of defined benefit pension actuarial losses | \$ (662) 252 | \$ (1,377) 514 | (b) Tax benefit |
| | \$ (410) | \$ (863) | Net of tax |
| Gains and losses on cash flow hedges: | | | |
| Interest rate contracts | \$ (7) | \$ (10) | Interest, net |
| Foreign exchange contracts | 2 | (3) | Cost of sales |
| | (5) | (13) | Total before tax |
| | 2 | 4 | Tax benefit |
| | \$ (3) | \$ (9) | Net of tax |
| Total reclassifications for the period | \$ (413) | \$ (872) | Net of tax |

- (a) Amounts in parentheses denote expense to statement of income.
(b) This component of accumulated other comprehensive income is included in the computation of net periodic benefit cost (see Note 8 for additional details).

11. SEGMENT REPORTING

The Company has three reportable segments: surfactants, polymers and specialty products. Segment operating results for the three months ended March 31, 2014 and 2013, are summarized below:

| <i>(In thousands)</i> | Surfactants | Polymers | Specialty Products | Segment Totals |
|--|-------------|------------|-----------------------|-------------------|
| <u>For the three months ended March 31, 2014</u> | | | | |
| Net sales | \$ 335,710 | \$ 119,107 | \$ 22,625 | \$ 477,442 |
| Operating income | 18,338 | 10,826 | 4,021 | 33,185 |
| <u>For the three months ended March 31, 2013</u> | | | | |
| Net sales | \$ 339,973 | \$ 95,998 | \$ 20,575 | \$ 456,546 |
| Operating income | 29,652 | 10,764 | 2,832 | 43,248 |

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

| <i>(In thousands)</i> | Three Months Ended March 31 | |
|--|--------------------------------|------------------|
| | 2014 | 2013 |
| Operating income segment totals | \$ 33,185 | \$ 43,248 |
| Unallocated corporate expenses ^(a) | (10,662) | (14,954) |
| Total operating income | 22,523 | 28,294 |
| Interest expense, net | (2,957) | (2,179) |
| Loss from equity in joint ventures | (1,451) | (1,413) |
| Other, net | (26) | 571 |
| Consolidated income before income taxes | \$ 18,089 | \$ 25,273 |

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

12. DEBT

At March 31, 2014, and December 31, 2013, debt comprised the following:

| <i>(In thousands)</i> | Maturity Dates | March 31, 2014 | December 31, 2013 |
|---|-------------------|-------------------|----------------------|
| Unsecured private placement notes | | | |
| 3.86% | 2019-2025 | \$ 100,000 | \$ 100,000 |
| 4.86% | 2017-2023 | 65,000 | 65,000 |
| 5.88% | 2016-2022 | 40,000 | 40,000 |
| 5.69% | 2014-2018 | 28,571 | 28,571 |
| 6.86% | 2014-2015 | 8,570 | 8,570 |
| Debt of foreign subsidiaries | | | |
| Secured bank term loans, foreign currency | 2014-2016 | 5,165 | 5,843 |
| Unsecured bank debt, U.S. dollars | 2014 | 702 | 998 |
| Other loans, foreign currency | 2014-2015 | 21,631 | 21,641 |
| Total debt | | \$ 269,639 | \$ 270,623 |
| Less current maturities | | 35,074 | 35,377 |
| Long-term debt | | \$ 234,565 | \$ 235,246 |

The Company has a committed \$125,000,000 multi-currency revolving credit agreement that expires in September 2017. The Company maintains standby letters of credit under its workers' compensation insurance agreements and for other purposes, as needed from time to time, which are issued under the revolving credit agreement. As of March 31,

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2014, the Company had outstanding letters of credit totaling \$2,977,000 and no outstanding debt under this agreement. There was \$122,023,000 available under the revolving credit agreement as of March 31, 2014.

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 \$159,653,000 and \$148,467,000 at March 31, 2014 and December 31, 2013, respectively.

13. OTHER, NET

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

| <i>(In thousands)</i> | Three Months Ended March 31 | |
|---|--------------------------------|----------|
| | 2014 | 2013 |
| Foreign exchange loss | \$ (205) | \$ (411) |
| Investment income | 156 | 84 |
| Realized and unrealized gain on investments | 23 | 898 |
| Other, net | \$ (26) | \$ 571 |

14. BUSINESS RESTRUCTURING

In the fourth quarter of 2013, the Company recorded a \$1,040,000 restructuring charge related to an approved plan to reduce future costs and increase operating efficiencies by consolidating a portion of its North American surfactants manufacturing operations (part of the surfactants reportable segment). The Company plans to shut down certain production areas at its Canadian manufacturing site, which will result in the elimination of an estimated 20 North American positions. Production of affected products currently manufactured in Canada will be moved to U.S. plants. The restructuring effort is expected to be completed in the third quarter of 2014. Below is a reconciliation of the beginning and ending balances of the restructuring liability:

| <i>(In thousands)</i> | Severance Expense |
|--|----------------------|
| Restructuring liability at December 31, 2013 | \$ 1,040 |
| Amounts paid | (288) |
| Restructuring liability at March 31, 2014 | \$ 752 |

Most of the severance payments are expected to be made in the third quarter of 2014. Other restructuring costs for this approved plan are not expected to be material.

In connection with the planned business restructuring, the Company reduced the useful lives of the manufacturing assets in the affected areas of the Canadian plant. The effect of the change in the useful lives of the assets was accelerated depreciation expenses of \$296,000 in 2013 and \$907,000 for the three months ended March 31, 2014. In addition, the Company expects to record approximately \$900,000 of accelerated depreciation expense in the second quarter ending June 30, 2014. The depreciation expense was included in the cost of sales line of the consolidated

statement of income.

15. ACQUISITION***2013 Acquisition***

On June 1, 2013, the Company acquired the North American polyester resins business of Bayer MaterialScience LLC (BMS). Prior to the acquisition, BMS was a North American producer of powder polyester resins for metal coating applications and liquid polyester resins for coatings, adhesives, sealants and elastomers (CASE) applications. The purchase included a 21,000-ton production facility in Columbus, Georgia, and a modern research and development laboratory for customer technical support and new product development. Infrastructure is in place to allow for future expansion. The acquisition has diversified the Company's polyol product offering and is expected to accelerate the Company's growth in CASE and PUSH (polyurethane systems house) applications. As of the acquisition date, the new business and acquired net assets became a part of the North American operations reporting unit included in the Company's polymers reportable segment.

The total acquisition purchase price was \$68,212,000 cash, of which \$61,067,000 was paid at closing and \$7,145,000 primarily for inventory was paid over a three-month period (June 2013 through August 2013) pursuant to a transition services agreement with BMS. The acquisition was originally funded through the Company's committed revolving credit agreement. Subsequent to closing on the acquisition, the Company completed a \$100,000,000 private placement loan, which was used in part to finance the acquisition (see Note 7).

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 following table summarizes the assets acquired and liabilities assumed:

| <i>(In thousands)</i> | June 1, 2013 |
|--------------------------------|---------------|
| Assets: | |
| Inventory | \$ 9,002 |
| Property, plant and equipment | 37,000 |
| Identifiable intangible assets | 17,800 |
| Goodwill | 4,642 |
| Total assets acquired | \$ 68,444 |
| Liabilities: | |
| Accrued expenses | 232 |
| Net assets acquired | \$ 68,212 |

The acquired goodwill, which was assigned entirely to the Company's North American operations reporting unit included in the Company's polymers reportable segment, is deductible for tax purposes. The goodwill reflects the potential marketing, manufacturing and raw material sourcing synergies of the new business with the Company's existing polymer business. Identifiable intangible assets included a technology and manufacturing know-how license agreement (\$7,900,000), a trademark/trade name (\$3,800,000) and customer relationships (\$6,100,000). The amortization periods for these intangibles at the time of acquisition were 8, 11 and 12 years, respectively. The purchase price allocation is final, and no purchase price allocation adjustments were made to the amounts originally recorded at the acquisition date.

The following is first quarter 2013 pro forma financial information prepared under the assumption that the acquisition of the BMS North American polyester resins business occurred on January 1, 2012.

Pro Forma Financial Information

Unaudited

| <i>(In thousands, except per share amounts)</i> | Three Months Ended March 31, 2013 |
|---|--------------------------------------|
| Net Sales | \$ 472,408 |
| Net Income Attributable to Stepan Company | \$ 19,335 |
| Net Income Per Common Share Attributable to Stepan Company: | |
| Basic | \$ 0.86 |
| Diluted | \$ 0.84 |

The supplemental pro forma information is presented for illustrative purposes only and may not be indicative of the consolidated results that would have actually been achieved by the Company. Furthermore, future results may vary significantly from the results reflected in the pro forma information. The pro forma results include adjustments primarily related to amortization of acquired intangible assets, depreciation of the fair value adjustment of acquisition-date plant assets, interest on borrowings and tax expense.

16. RECENT ACCOUNTING PRONOUNCEMENTS

In February 2013, the FASB issued ASU No. 2013-04, *Liabilities (Topic 405), Obligations Resulting from Joint and Several Liability Arrangements for Which the Total Amount of the Obligation is Fixed at the Reporting Date*. This update requires an entity to measure obligations resulting from joint and several liability arrangements for which the total amount of the obligation is fixed at the reporting date, as the sum of a) the amount the reporting entity agreed to pay on the basis of its arrangement among its co-obligors and b) any additional amount the reporting entity expects to pay on behalf of its co-obligors. The update also requires an entity to disclose the nature and amount of the obligation as well as other information about those obligations. The requirements of ASU No. 2013-04 are effective on a retrospective basis for interim and annual periods beginning after December 15, 2013. Because the Company has no applicable obligations resulting from joint and several liability arrangements, adoption of ASU No. 2013-04 did not have a material impact on the Company's financial position, results of operations or cash flows.

In July 2013, the FASB issued ASU No. 2013-11, *Income Taxes (Topic 740), Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*. The update clarifies that unrecognized tax benefits related to a net operating loss carryforward, or similar tax loss, or tax credit carryforward, should generally be presented in the financial statements as a reduction to a deferred tax asset. The requirements of ASU No. 2013-11 are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. The update allows for early adoption. The Company currently has no unrecognized tax benefits in jurisdictions where a net operating loss carryforward, or similar tax loss, or tax credit carryforward exists. The adoption of the new guidance did not have a material impact on the Company's financial position, results of operations or cash flows.

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

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

The matters discussed in the following discussion and analysis include forward-looking statements that are subject to certain risks, uncertainties and assumptions. Such forward-looking statements are intended to be identified in this document by the words, anticipate, believe, estimate, expect, intend, may, objective, outlook, plan, potential, should and similar expressions. Actual results may vary materially.

Forward-looking statements speak only as of the date they are made, and the Company does not undertake any obligation to update them to reflect changes that occur after that date. Factors that could cause actual results to differ materially include the items described in Item 1A of the Company's Annual Report on Form 10-K for the year ended December 31, 2013.

Overview

The Company produces and sells intermediate chemicals that are used in a wide variety of applications worldwide. The overall business comprises three reportable segments:

Surfactants Surfactants, which accounted for 70 percent of consolidated net sales in the first quarter of 2014, 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), three Latin American sites (Mexico, Brazil and Colombia) and two Asian sites (Philippines and Singapore). The Company also holds a 50 percent ownership interest in a joint venture, TIORCO, LLC (TIORCO), that markets chemical solutions for increasing the production of crude oil and natural gas from existing fields (enhanced oil recovery or EOR). The joint venture is accounted for under the equity method, and its financial results are excluded from surfactant segment operating results. Sales and related profits of the Company's surfactants to enhanced oil recovery customers are included in surfactants segment results.

Polymers Polymers, which accounted for 25 percent of consolidated net sales in the first quarter of 2014, 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 resins, are used in CASE and polyurethane systems house applications. 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 polyester resins are manufactured at the Company's Columbus, Georgia, site. In Europe, polyols are manufactured at the Company's subsidiaries in Germany and Poland. In Asia, polyols are currently toll produced for the Company's 80-percent owned joint venture in Nanjing, China.

Specialty Products Specialty products, which accounted for 5 percent of consolidated net sales in the first quarter of 2014, 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.

Deferred Compensation Plans

The accounting for the Company's deferred compensation plans can cause period-to-period fluctuations in Company expenses and profits. Compensation expense results when the values of Company common stock and mutual fund investment assets held for the plans increase, and compensation income results when the values of Company common stock and mutual fund investment assets decline. The pretax effect of all deferred compensation-related activities (including realized and unrealized gains and losses on the mutual fund assets held to fund the deferred compensation obligations) and the income statement line items in which the effects of the activities were recorded are displayed in the following table:

| <i>(In millions)</i> | Income (Expense) For the Three Months Ended March 31 | | |
|---|--|----------|-----------------------|
| | 2014 | 2013 | Change |
| Deferred Compensation (Administrative expense) | \$ 0.2 | (\$ 4.9) | \$ 5.1 ⁽¹⁾ |
| Realized/Unrealized Gains on Investments (Other, net) | | 0.8 | (0.8) |
| Investment Income (Other, net) | 0.2 | 0.1 | 0.1 |
| Pretax Income Effect | \$ 0.4 | (\$ 4.0) | \$ 4.4 |

- ⁽¹⁾ See the Corporate Expenses section of this management's discussion and analysis for details regarding the quarter-over-quarter change in deferred compensation expense.

Effects of Foreign Currency Translation

The Company's foreign subsidiaries transact business and report financial results in their respective local currencies. As a result, foreign subsidiary income statements are translated into U.S. dollars at average foreign exchange rates appropriate for the reporting period. Because foreign exchange rates fluctuate against the U.S. dollar over time, foreign currency translation affects period-to-period comparisons of financial statement items (i.e., because foreign exchange rates fluctuate, similar period-to-period local currency results for a foreign subsidiary may translate into different U.S. dollar results). The following table presents the effects that foreign currency translation had on the quarter-over-quarter changes in consolidated net sales and various income line items between the quarters ended March 31, 2014 and 2013:

| <i>(In millions)</i> | Three Months Ended | | (Decrease) | |
|----------------------|--------------------|---------------|---------------------|----------------------------|
| | March 31 2014 | March 31 2013 | Increase (Decrease) | Due to Foreign Translation |
| Net Sales | \$ 477.4 | \$ 456.5 | \$ 20.9 | (\$ 1.7) |
| Gross Profit | 63.0 | 72.7 | (9.7) | (0.4) |
| Operating Income | 22.5 | 28.3 | (5.8) | (0.3) |
| Pretax Income | 18.1 | 25.3 | (7.2) | |

RESULTS OF OPERATIONS

Three Months Ended March 31, 2014 and 2013*Summary*

Net income attributable to the Company for the first quarter of 2014 declined 32 percent quarter-over-quarter to \$13.0 million, or \$0.57 per diluted share, compared to \$19.0 million, or \$0.83 per diluted share, for the first quarter of 2013. The current quarter's financial results were negatively impacted by the effects of protracted severe winter weather in the U.S. that led to higher maintenance, utility and transportation costs and to some lost sales volume due to Company and customer plant disruptions. Below is a summary discussion of the major factors leading to the quarter-over-quarter changes in net sales, profits and expenses. A detailed discussion of segment operating performance for the first quarter of 2014 follows the summary.

Consolidated net sales increased \$20.9 million, or five percent, quarter over quarter. Higher average selling prices favorably affected the net sales change by \$33.2 million. A two percent decline in sales volume and the effects of foreign currency translation offset the average selling price impact by \$10.6 million and \$1.7 million, respectively. The increase in average selling prices was partially attributable to higher quarter-over-quarter raw material costs for surfactants. The polymers segment accounted for the consolidated sales volume improvement. The acquired Bayer MaterialScience LLC (BMS) North American polyester resins business (purchased in the second quarter of 2013) and strong quarter-over-quarter growth for European operations drove the polymer increase. Surfactants sales volume declined six percent due to

reduced quarter-over-quarter volumes for North American operations resulting from lower biodiesel sales and the effects of prolonged extreme winter weather. Sales volumes for the specialty products segment declined nine percent due to a decrease in sales volume for food and flavoring products partially offset by an increase in sales volume for nutritional supplement and pharmaceutical products.

Operating income for the first quarter of 2014 declined \$5.8 million, or 20 percent, from operating income reported for the last year's first quarter. Gross profit fell \$9.7 million, or 13 percent, largely due to lower profits for surfactants caused by higher manufacturing and transportation expenses and lower sales volume for operations in North America. The effect of the previously noted higher surfactants raw material costs was more than offset by selling price increases.

Operating expenses declined \$3.9 million, or nine percent, between quarters. Deferred compensation expense accounted for \$5.1 million of the decrease. The following summarizes the quarter-over-quarter changes in the individual income statement line items that comprise the Company's operating expenses:

Administrative expenses declined \$4.9 million, or 25 percent, quarter over quarter due to a \$5.1 million reduction in deferred compensation expense. A first quarter 2014 decrease in the value of Company stock compared to a first quarter 2013 increase in the value of Company common stock caused the decline. See the Overview and Corporate Expenses sections of this MD&A for further details.

Selling expenses increased \$0.4 million, or three percent, quarter over quarter. The increase was mainly attributable to a \$0.5 million increase in bad debt provision for a Latin American customer that moved into bankruptcy.

Research, development and technical service expenses (R&D) were up \$0.6 million, or five percent, quarter over quarter. The increase in R&D expenses reflected higher expenses for salaries and outside testing services for North American operations partially offset by lower product registration expenses in Europe.

Net interest expense for the first quarter of 2014 increased \$0.8 million, or 36 percent, over net interest expense for the first quarter of 2013. The increase reflected higher quarter-over-quarter average debt levels arising from a \$100.0 million private placement note purchase agreement the Company executed in the second quarter of 2013. The Company borrowed the funds to finance the second quarter 2013 BMS North American polyester resins acquisition, other capital expenditures and general corporate purposes.

Other, net was less than \$0.1 million of expense for the first quarter of 2014 compared to \$0.6 million of income for the same period of 2013. Investment income (including realized and unrealized gains and losses) for the Company's deferred compensation and supplemental defined contribution mutual fund assets was \$0.2 million in the first quarter of 2014 compared to \$1.0 million in last year's first quarter. Foreign exchange losses totaled \$0.2 million for the first quarter of 2014 compared to \$0.4 million for the first quarter of 2013.

The effective tax rate was 28.1 percent for the first quarter of 2014 compared to 24.8 percent for the first quarter of 2013. The increase was primarily attributable to the expiration of the U.S. research and development tax credit and the small agri-biodiesel producer tax credit which were retroactively extended from January 1, 2012 through December 31, 2013 in January 2013. The Company recorded a tax benefit of \$1.4 million in the first quarter of 2013 for amounts generated in 2012 and a tax benefit of \$0.4 million for amounts generated in 2013. This increase was partially offset by a greater percentage of consolidated income being generated outside the U.S. where the effective tax rates are generally lower.

Segment Results

| <i>(In thousands)</i> | Surfactants | Polymers | Specialty Products | Segment Results | Corporate | Total |
|--|-------------|------------|--------------------|-----------------|-----------|------------|
| <u>For the three months ended March 31, 2014</u> | | | | | | |
| Net sales | \$ 335,710 | \$ 119,107 | \$ 22,625 | \$ 477,442 | | \$ 477,442 |
| Operating income | 18,338 | 10,826 | 4,021 | 33,185 | (10,662) | 22,523 |
| <u>For the three months ended March 31, 2013</u> | | | | | | |
| Net sales | \$ 339,973 | \$ 95,998 | \$ 20,575 | \$ 456,546 | | \$ 456,546 |
| Operating income | 29,652 | 10,764 | 2,832 | 43,248 | (14,954) | 28,294 |

Surfactants

Surfactants net sales for the first quarter of 2014 declined \$4.3 million, or one percent, from net sales for the first quarter of 2013. A six percent drop in sales volume, largely due to lower biodiesel sales and to the impact of severe winter conditions, and the effects of foreign currency translation accounted for \$22.1 million and \$3.0 million, respectively, of the net sales decline. An increase in average selling prices favorably affected the net sales change by \$20.8 million. A quarter-over-quarter comparison of net sales by region follows:

| <i>(In thousands)</i> | For the Three Months Ended | | Increase | Percent |
|----------------------------------|----------------------------|-------------------|-------------------|-----------|
| | March 31, 2014 | March 31, 2013 | (Decrease) | Change |
| North America | \$ 208,424 | \$ 211,462 | \$ (3,038) | -1 |
| Europe | 75,358 | 78,183 | (2,825) | -4 |
| Latin America | 38,707 | 38,202 | 505 | +1 |
| Asia | 13,221 | 12,126 | 1,095 | +9 |
| Total Surfactants Segment | \$ 335,710 | \$ 339,973 | \$ (4,263) | -1 |

Net sales for North American operations declined one percent due to a twelve percent decrease in sales volume and the unfavorable effects of foreign currency translation, which accounted for \$24.5 million and \$1.3 million, respectively, of the decline in net sales. Lower quarter-over-quarter biodiesel sales accounted for approximately 60 percent of the decline in North American sales volume. In 2013, the Company had some low-margin opportunistic biodiesel business that did not recur in 2014. Decreased sales of products used in laundry and cleaning and personal care applications contributed to the North American sales volume decline. The decline in laundry and cleaning and personal care sales volume was partially attributable to the severe winter weather that caused production issues at the Company's and customers

manufacturing facilities. Lost business due to the closure of a customer's plant also contributed to the lower sales volume for laundry and cleaning and personal care products. Average selling prices increased twelve percent, which offset the effects of the sales volume decline and unfavorable foreign currency translation by \$22.8 million. Higher quarter-over-quarter raw material costs led to the increase in average selling prices.

Net sales for European operations declined four percent due to a six percent decrease in sales volume and a three percent decrease in average selling prices, which accounted for \$4.6 million and \$1.9 million, respectively, of the quarter-over-quarter net sales decline. The favorable effects of foreign currency translation mitigated the decrease in net sales by \$3.7 million. The decline in sales volume reflected lower demand for laundry and cleaning and personal care products as well as some lost business resulting from competitive pricing situations. Sales volumes for functional surfactants, primarily agricultural and emulsion polymers and foamers products, were up between quarters. Selling prices declined as a result of cost decreases for a number of major raw materials.

Net sales for Latin American operations increased one percent due to a 10 percent increase in sales volume and a three percent increase in average selling prices, which accounted for \$3.7 million and \$1.0 million, respectively, of the quarter-over-quarter net sales change. The effects of foreign currency translation negatively affected the change in net sales by \$4.2 million. All Latin American locations posted quarter-over-quarter sales volume increases, with most of the improvement occurring in Brazil where the Company continues its strong emphasis on growth. The foreign currency translation effect resulted from the quarter-over-quarter weakening of the Brazilian real and Colombian and Mexican pesos against the U.S. dollar.

Net sales for Asian operations increased nine percent due to a seven percent increase in sales volume and increased average selling prices partially offset by \$1.2 million of unfavorable foreign currency translation effect. The sales volume improvement was attributable to new business for the Singapore location.

Surfactants operating income for the first quarter of 2014 declined \$11.3 million, or 38 percent, from operating income for the first quarter of 2013. Gross profit decreased \$10.8 million principally due to lower sales volume and higher expenses in North America largely as a result of severe and prolonged winter conditions. The effect of higher average surfactants raw material costs was more than offset by selling price increases. Foreign currency translation contributed \$0.6 million to the gross profit decline. Operating expenses increased \$0.5 million, or two percent. Quarter-over-quarter comparisons of gross profit by region and total segment operating expenses and operating income follow:

| <i>(In thousands)</i> | For the Three Months | | Increase (Decrease) | Percent Change |
|----------------------------------|----------------------|----------------|------------------------|-------------------|
| | March 31, 2014 | March 31, 2013 | | |
| Gross Profit | | | | |
| North America | \$ 24,973 | \$ 39,474 | \$ (14,501) | -37 |
| Europe | 7,336 | 6,869 | 467 | +7 |
| Latin America | 5,303 | 5,492 | (189) | -3 |
| Asia | 3,196 | (187) | 3,383 | NM |
| Surfactants Segment Gross Profit | \$ 40,808 | \$ 51,648 | \$ (10,840) | -21 |
| Operating Expenses | 22,470 | 21,996 | 474 | +2 |
| Operating Income | \$ 18,338 | \$ 29,652 | \$ (11,314) | -38 |

North American gross profit declined 37 percent quarter over quarter due to lower sales volume and higher expenses. Manufacturing costs were up \$4.1 million, or 13 percent, quarter over quarter largely due to increased maintenance and utility costs caused by prolonged inclement winter weather. The Company also incurred additional transportation expenses due to the transfer of some production in weather-affected locations to other less impacted North American plants. Unrelated to the weather, the Company's Canadian plant recognized \$0.9 million of accelerated depreciation related to the restructuring plan approved in the fourth quarter of 2013.

Gross profit for European operations increased seven percent quarter over quarter. Lower raw material costs, a more favorable mix of sales and a \$0.3 million favorable foreign currency translation effect more than offset the impact of a six percent decline in sales volume.

Gross profit for Latin American operations declined three percent despite the 10 percent improvement in sales volume. An unfavorable \$0.8 million foreign currency translation impact more than offset the effect of the higher sales volume.

The quarter-over-quarter increase in gross profit for Asian operations was driven by increased sales volume for Singapore. Commercial operations at the Singapore plant were just underway in the year-ago quarter.

Operating expenses for the surfactants segment were up \$0.5 million, or two percent, quarter over quarter. The expense increase was mainly attributable to an increase in bad debt provision for a Latin American customer that moved into bankruptcy. The effects of foreign currency translation reduced the operating expense increase by \$0.2 million.

Polymers

Polymers net sales for the first quarter of 2014 increased \$23.1 million, or 24 percent, over net sales for the first quarter of 2013. A 20 percent increase in sales volume, higher average selling prices and the effects of foreign currency translation accounted for \$19.6 million, \$2.4 million and \$1.1 million, respectively, of the quarter-over-quarter net sales improvement. The increase in sales volume was attributable to the acquired BMS North American polyester resins business (purchased in the second quarter of 2013) and to solid growth for European operations. A quarter-over-quarter comparison of net sales by region follows:

| <i>(In thousands)</i> | For the Three Months Ended | | | Percent Change |
|------------------------|----------------------------|----------------|-----------|-------------------|
| | March 31, 2014 | March 31, 2013 | Increase | |
| North America | \$ 73,685 | \$ 60,059 | \$ 13,626 | +23 |
| Europe | 41,676 | 33,050 | 8,626 | +26 |
| Asia and Other | 3,746 | 2,889 | 857 | +30 |
| Total Polymers Segment | \$ 119,107 | \$ 95,998 | \$ 23,109 | +24 |

Net sales for North American operations increased 23 percent primarily due to the effects of the acquired BMS North American polyester resins business (purchased in the second quarter of 2013). The acquired business accounted for \$17.5 million of the quarter-over-quarter net sales increase. Without the acquired polyester resins business, net sales declined \$3.9 million, or seven percent, due to a four percent decrease in average selling prices (reflecting lower average raw material costs) and a two percent decrease in sales volume. Sales volumes for polyols used in rigid foam applications improved five percent. Phthalic anhydride sales volume declined 10 percent due to lost sales at a large customer.

Net sales for European operations increased 26 percent due to a 29 percent increase in sales volume and to the effects of foreign currency translation, which accounted for \$9.6 million and \$1.2 million, respectively, of the net sales improvement. Local regulations aimed at increasing energy conservation and heightened interest in energy-efficient insulation materials continued to create strong demand for the Company's polyol products used in rigid insulation board and metal panels. Average selling prices declined five percent, which tempered the quarter-over-quarter net sales improvement by \$2.2 million.

Net sales for Asia and Other operations increased 30 percent quarter over quarter due to an 11 percent increase in sales volume and higher average selling prices. The Company is currently supplying customers in China and other parts of Asia with product imported from other Company sites and from local manufacturers. This sourcing is expected to continue until a new plant in China is constructed.

Polymer operating income for the first quarter of 2014 increased \$0.1 million, or one percent, over operating income for the first quarter of 2013. Gross profit increased \$0.7 million quarter-over-quarter, due to a 20 percent increase in sales volume partially offset by the effects of reduced sales margins. Operating expenses increased \$0.7 million, or 11 percent. Quarter-over-quarter comparisons of gross profit by region and total segment operating expenses and operating income follow:

| <i>(In thousands)</i> | For the Three Months Ended | | | Percent Change |
|-------------------------------|-------------------------------|----------------|----------|-------------------|
| | March 31, 2014 | March 31, 2013 | Increase | |
| <u>Gross Profit</u> | | | | |
| North America | \$ 11,434 | \$ 11,411 | \$ 23 | |
| Europe | 5,521 | 5,137 | 384 | +7 |
| Asia and Other | 310 | 3 | 307 | NM |
| Polymers Segment Gross Profit | \$ 17,265 | \$ 16,551 | \$ 714 | +4 |
| Operating Expenses | 6,439 | 5,787 | 652 | +11 |
| Operating Income | \$ 10,826 | \$ 10,764 | \$ 62 | +1 |

Gross profit for North American operations increased less than one percent despite the positive contributions of the acquired BMS North American polyester resins business and the sales volume improvement for polyols used in rigid foam applications. Sales of phthalic anhydride contributed \$2.2 million less to profit in the first quarter of 2014 than in the first quarter of 2013 due to lower sales volume, higher manufacturing expenses and a less favorable inventory position for orthoxylene (raw material for phthalic anhydride). Phthalic anhydride manufacturing costs were 17 percent higher quarter over quarter due to increased maintenance and utility costs caused by extended severe winter conditions.

Gross profit for European operations increased seven percent due to the increase in sales volume. Selling price reductions and higher manufacturing expenses partially offset the effect of the improved sales volume. Current quarter manufacturing expenses were higher than last year's quarter partially due to favorable nonrecurring adjustments made in 2013.

The increase in gross profit for Asia and Other operations was due to the increase in sales volume and to a more favorable mix of sales.

Operating expenses for the polymers segment were up \$0.7 million, or 11 percent, quarter over quarter. The increase reflected additional expenses to support the BMS North American polyester resins business (purchased in the second quarter of 2013). The effects of foreign currency translation contributed \$0.1 million to the increase.

Specialty Products

Net sales for the first quarter of 2014 increased \$2.1 million, or 10 percent, over net sales for the first quarter of 2013 despite a nine percent decrease in sales volume. Lower quarter-over-quarter sales of products used in food and flavoring applications partially offset by higher sales volumes for products used in nutritional supplement and pharmaceutical applications accounted for the sales volume decline. Selling price increases coupled with a more favorable sales mix more than offset the effect of the sales volume decline. Operating income increased \$1.2 million, or 42 percent, quarter over quarter due to higher selling prices and a more profitable mix of sales.

Corporate Expenses

Corporate expenses, which comprise operating expenses that are not allocated to the reportable segments, declined \$4.3 million to \$10.7 million for the first quarter of 2014 from \$15.0 million for the same quarter of 2013. The quarter-over-quarter decline in corporate expenses was attributable to a \$5.1 million decrease in deferred compensation expense (\$0.2 million of income for the first quarter of 2014 compared to \$4.9 million of expense for the first quarter of 2013). A first quarter 2014 decrease (\$1.07 per share) in the value of Company stock, to which a substantial portion of the deferred compensation obligation is tied, compared to a first quarter 2013 increase (\$7.56 per share) in the value of Company common stock led to the quarter-over-quarter decline in deferred compensation expense. The following table presents the quarter end Company common stock market prices used in the computation of deferred compensation expense:

| | 2014 | 2013 | 2012 | |
|---------------------|--------------|--------------|--------------|----------|
| | 3/31 | 12/31 | 3/31 | |
| | 12/31 | | 12/31 | |
| Company Stock Price | \$ 64.56 | \$ 65.63 | \$ 63.10 | \$ 55.54 |

Higher patent fees to support the Company's innovation growth endeavors and exploratory acquisition expenses partially offset the decrease in deferred compensation expense.

LIQUIDITY AND CAPITAL RESOURCES

For the three months ended March 31, 2014, operating activities were a cash use of \$9.0 million versus a use of \$9.9 million for the comparable period in 2013. For the current year period, investing cash outflows totaled \$23.1 million and financing activities consumed \$4.0 million. Overall, cash declined by \$36.6 million in the first quarter of 2014, including a \$0.5 million reduction attributable to foreign currency translation.

For the current year-to-date, net income was down by \$6.0 million and working capital consumed \$7.6 million less than for the comparable year-ago period. Cash outflows for investing activities were up by \$0.2 million year over year. Cash flow for financing activities was a use of \$4.0 million in 2014 compared to a source of \$11.3 million in 2013.

For the current year-to-date, accounts receivable were a use of \$30.0 million compared to a use of \$31.8 million for the comparable period in 2013. Inventories were a use of \$13.2 million in 2014 versus a use of \$16.5 million in 2013. Accounts payable and accrued liabilities were a cash source of \$6.3 million in 2014 compared to a source of \$5.5 million for the same period in 2013.

Working capital requirements were lower during the first three months of 2014, compared to the same quarter in 2013 due to lower sales quantities, partially offset by rising raw material costs which drove higher average selling prices to customers. The Company's working capital investment is heavily influenced by the cost of crude oil and natural oils, from which many of its raw materials are derived. Fluctuations in raw material costs translate directly to inventory carrying costs and indirectly to customer selling prices and accounts receivable.

The increase in accounts receivable since December 31, 2013, was driven approximately equally by the combination of higher quarterly sales volumes and higher selling prices, partially offset by improved accounts receivable turnover since year-end. Slightly more than half of the year-to-date inventory increase resulted from higher raw material costs with the remainder attributable to planned increases to support customer service levels. The Company has not changed its own payment practices related to its payables. It is management's opinion that the Company's liquidity is sufficient to provide for potential increases in working capital during 2014.

Investing cash outflows for the current year-to-date included capital expenditures of \$20.5 million compared to \$21.0 million for the comparable period last year. Other investing activities consumed \$2.6 million in 2014 versus \$1.9 million in 2013.

For 2014, the Company estimates that capital expenditures will range from \$100 million to \$110 million including capacity expansions in Brazil, Germany, Singapore and the United States.

The Company purchases its common shares in the open market from time to time to fund its own benefit plans and also to mitigate the dilutive effect of new shares issued under its benefit plans. The Company may also make open market repurchases as cash flows permit when, in management's opinion, the Company's shares are undervalued in the market. For the first three months of 2014, the Company purchased 7,180 shares in the open market at a total cost of \$0.4 million. At March 31, 2014, there were 951,132 shares remaining under the current share repurchase authorization.

As of March 31, 2014, the Company's cash and cash equivalents totaled \$96.7 million, including \$29.7 million in two separate U.S. money market funds, each of which was rated AAA by Standard and Poor's and Aaa by Moody's. Cash in U.S. demand deposit accounts totaled \$21.3 million and cash of the Company's non-U.S. subsidiaries held outside the U.S. totaled \$45.7 million at March 31, 2014.

Consolidated balance sheet debt decreased by \$1.0 million for the current year-to-date, from \$270.6 million to \$269.6 million. Since last year-end, foreign debt decreased by \$1.0 million and domestic debt was unchanged. Net debt (which is defined as total debt minus cash) increased by \$35.6 million for the current year-to-date, from \$137.3 million to \$172.9 million. As of March 31, 2014, the ratio of total debt to total debt plus shareholders' equity was 32.3 percent compared to 32.8 percent at December 31, 2013. As of March 31, 2014, the ratio of net debt to net debt plus shareholders' equity was 23.5 percent compared to 19.9 percent at December 31, 2013.

At March 31, 2014, the Company's debt included \$242.1 million of unsecured private placement loans with maturities extending from 2014 through 2025. These loans are the Company's primary source of long-term debt financing and are supplemented by bank credit facilities to meet short and medium-term needs.

The Company has a committed \$125.0 million multi-currency syndicated revolving credit agreement. The credit agreement allows the Company to make unsecured borrowings, as requested from time to time, for working capital and other corporate purposes. This unsecured facility is the Company's primary source of short-term borrowings and is committed through September 20, 2017, with terms and conditions that are substantially equivalent to those of the Company's other U.S. loan agreements. As of March 31, 2014, the Company had outstanding letters of credit of \$3.0 million and no borrowings under this agreement, with \$122.0 million remaining available. The Company anticipates that cash from operations, committed credit facilities and cash on hand will be sufficient to fund anticipated capital expenditures, working capital, dividends and other planned financial commitments for the foreseeable future.

Certain foreign subsidiaries of the Company maintain term loans and short-term bank lines of credit in their respective local currencies to meet working capital requirements as well as to fund capital expenditure programs and acquisitions. At March 31, 2014, the Company's European subsidiaries had bank term loans of \$5.2 million with maturities through 2016 and short-term bank debt of \$21.6 million with remaining short-term borrowing capacity of \$15.1 million. The Company's Latin American subsidiaries had no short-term bank debt with \$16.3 million of unused short-term borrowing capacity. The Company's Philippine subsidiary had \$0.7 million of short-term bank loans, which were guaranteed by the Company, with \$7.3 million of unused borrowing capacity. The Company's majority-owned joint venture in China had no short-term bank debt, with unused borrowing capacity of \$6.5 million, on bank credit lines guaranteed by the Company.

The Company has material debt agreements that require the maintenance of minimum interest coverage and minimum net worth. These agreements also limit the incurrence of additional debt as well as the payment of dividends and repurchase of treasury shares. Testing for these agreements is based on the combined financial statements of the U.S. operations of the Company, Stepan Canada Inc., Stepan Quimica Ltda., Stepan Specialty Products, LLC, Stepan Specialty Products B.V. and Stepan Asia Pte. Ltd. (the Restricted Group). Under the most restrictive of these debt covenants:

1. The Restricted Group must maintain a minimum interest coverage ratio, as defined within the agreements, of 2.0 to 1.0, for the preceding four calendar quarters.
2. The Restricted Group must maintain net worth of at least \$275.0 million.
3. The Restricted Group must maintain a ratio of long-term debt to total capitalization, as defined in the agreements, not to exceed 55 percent.
4. The Restricted Group may pay dividends and purchase treasury shares after December 31, 2011, in amounts of up to \$100.0 million plus 100 percent of net income and cash proceeds of stock option exercises, measured cumulatively after June 30, 2012. The maximum amount of dividends that could have been paid within this limitation is disclosed as unrestricted retained earnings in Note 13, Debt, in the Notes to Consolidated Financial Statements.

The Company believes it was in compliance with all of its loan agreements as of March 31, 2014. Based on current projections, the Company believes it will be in compliance with its loan agreements throughout 2014.

ENVIRONMENTAL AND LEGAL MATTERS

The Company is subject to extensive federal, state and local environmental laws and regulations. Although the Company's environmental policies and practices are designed to ensure compliance with these laws and regulations, future developments and increasingly stringent environmental regulation could require the Company to make additional unforeseen environmental expenditures. The Company will continue to invest in the equipment and facilities necessary to comply with existing and future regulations. During the first three months of 2014 and 2013, the Company's expenditures for capital projects related to the environment were \$0.5 million and \$1.5 million, respectively. These projects are capitalized and depreciated over their estimated useful lives, which are typically 10 years. Recurring costs associated with the operation and maintenance of facilities for waste treatment and disposal and managing environmental compliance in ongoing operations at the Company's manufacturing locations were \$4.7 million and \$4.1 million for the three months ended March 31, 2014 and 2013, respectively. While difficult to project, it is not anticipated that these recurring expenses will increase significantly in the future.

Over the years, the Company has received requests for information related to or has been named by the government as a potentially responsible party 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 the sites. It is the Company's accounting policy to record liabilities when environmental assessments and/or

remedial efforts are probable and the cost or range of possible costs can be reasonably estimated. When no amount within the range is a better estimate than any other amount, the minimum is accrued. Some of the factors on which the Company bases its estimates include information provided by feasibility studies, potentially responsible party negotiations and the development of remedial action plans. After partial remediation payments at certain sites, the Company has estimated a range of possible environmental and legal losses of \$10.2 million to \$29.0 million at March 31, 2014, compared to \$9.7 million to \$28.9 million at December 31, 2013. At March 31, 2014, and December 31, 2013, the Company's accrued liability for such losses, which represented the Company's best estimate within the estimated range of possible environmental and legal losses, was \$15.2 million and \$14.7 million, respectively. During the first three months of 2014, cash outlays related to legal and environmental matters approximated \$0.3 million compared to \$0.6 million for the first three months of 2013.

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. Certain of these matters are discussed in Item 1, Part 2, Legal Proceedings, in this report and in other filings of the Company with the Securities and Exchange Commission, which are available upon request from the Company. See also Note 7 to the condensed consolidated financial statements for a summary of the environmental proceedings related to certain environmental sites.

OUTLOOK

Lower first quarter earnings were largely due to the adverse winter weather in North America and other issues which generally should not recur. In March and April the Company's business seems back on track; however lower first quarter earnings will make it a challenge to exceed 2013 full year earnings from operations.

Despite this setback, the Company remains on track in delivering its strategic objectives. The Company continues to recognize earnings growth from the 2013 acquisition from BMS and previous capacity expansions in Brazil, Europe and Singapore. The Company's balance sheet is healthy, and management will continue to pursue investments that will accelerate Company growth.

Surfactant earnings should improve as the year progresses driven by greater agricultural sales, continued consumer product growth in Brazil, projected demand for enhanced oil recovery surfactants as well as gains from operational efficiencies.

Polymers should continue grow. Improving economies in the U.S. and Europe, as well as the recent conversions of insulated metal panel and new C.A.S.E. customers, should contribute to full year organic earnings growth. The North American polyester resin business purchased from BMS is now fully integrated and is delivering the benefits previously projected.

CRITICAL ACCOUNTING POLICIES

There have been no changes to the critical accounting policies disclosed in the Company's 2013 Annual Report on Form 10-K.

Item 3 Quantitative and Qualitative Disclosures about Market Risk

There have been no material changes to the market risks disclosed in the Company's 2013 Annual Report on Form 10-K.

Item 4 Controls and Procedures

a. Evaluation of Disclosure Controls and Procedures

Based on their evaluation of our disclosure controls and procedures as of the end of the most recent fiscal quarter covered by this Form 10-Q, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934) were effective as of March 31, 2014.

b. Changes in Internal Control Over Financial Reporting

There were no changes in internal controls that occurred during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Part II OTHER INFORMATION**Item 1 Legal Proceedings**

There have been no material changes to the legal proceedings disclosed in the Company's 2013 Annual report on Form 10-K.

Item 1A Risk Factors

There have been no material changes to the risk factors disclosed in the Company's 2013 Annual Report on Form 10-K.

Item 2 Unregistered Sales of Equity Securities and Use of Proceeds

Below is a summary by month of share purchases by the Company during the first quarter of 2014:

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs |
|---------------|---|-------------------------------------|---|---|
| January | | | | |
| February | 1,583 ^(a) | \$ 63.06 | | |
| March | 7,204 ^(b) | \$ 59.92 | | |

(a) Represents shares of Company common stock tendered by employees to settle minimum statutory withholding taxes related to deferred performance stock award and deferred compensation distributions.

(b) Includes 24 shares of Company common stock tendered by employees to settle minimum statutory withholding taxes related to deferred compensation distributions. The remainder of the shares were purchased in the open market.

Item 3 Defaults Upon Senior Securities

None

Item 4 Mine Safety Disclosures

Not applicable

Item 5 Other Information

None

Item 6 Exhibits

- (a) Exhibit 31.1 Certification of President and Chief Executive Officer pursuant to Exchange Act Rule 13a-14(a)/15d-14(a)
- (b) Exhibit 31.2 Certification of Vice President and Chief Financial Officer pursuant to Exchange Act Rule 13a-14(a)/15d-14(a)
- (c) Exhibit 32 Certification pursuant to 18 U.S.C. Section 1350
- (d) Exhibit 101.INS XBRL Instance Document
- (e) Exhibit 101.SCH XBRL Taxonomy Extension Schema Document
- (f) Exhibit 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
- (g) Exhibit 101.DEF XBRL Taxonomy Extension Definition Document
- (h) Exhibit 101.LAB XBRL Taxonomy Extension Label Linkbase Document
- (i) Exhibit 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: April 30, 2014

STEPAN COMPANY

/s/ Scott D. Beamer
Scott D. Beamer
Vice President and Chief Financial Officer