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STEPAN CO  
Form 10-Q/A  
December 27, 2002

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

-----  
FORM 10-Q/A  
Amendment No. 1

(MARK ONE)

- ( X ) QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934  
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2002
- ( ) 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

36 1823834

-----  
(State or other jurisdiction of  
incorporation or organization)

(I.R.S. Employer  
Identification Number)

Edens and Winnetka Road, Northfield, Illinois 60093

-----  
(Address of principal executive offices)

Registrant's telephone number

(847) 446-7500  
-----

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No  
-----

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

| Class                                | Outstanding at July 31, 2002 |
|--------------------------------------|------------------------------|
| -----<br>Common Stock, \$1 par value | -----<br>8,862,425 Shares    |

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Explanatory Note

This amendment to Form 10-Q is being filed to give effect to the restatement of Stepan Company's condensed consolidated financial statements for the quarters and six months ended June 30, 2002 and 2001, and the year ended December 31, 2001, as discussed in Note 3 to the Condensed Consolidated Financial Statements.

Part I FINANCIAL INFORMATION  
Item 1 - Financial Statements

STEPAN COMPANY  
CONDENSED CONSOLIDATED BALANCE SHEETS  
June 30, 2002 and December 31, 2001

(Dollars in thousands) Unaudited

ASSETS

CURRENT ASSETS:

Cash and cash equivalents  
Receivables, net  
Inventories (Note 4)  
Deferred income taxes  
Other current assets

Total current assets

PROPERTY, PLANT AND EQUIPMENT:

Cost  
Less: accumulated depreciation

Property, plant and equipment, net

LONG TERM INVESTMENTS

GOODWILL, NET (Note 9)

OTHER INTANGIBLE ASSETS, NET (Note 9)

OTHER NON-CURRENT ASSETS

Total assets

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### LIABILITIES AND STOCKHOLDERS' EQUITY

#### CURRENT LIABILITIES:

Current maturities of long-term debt  
 Accounts payable  
 Accrued liabilities

Total current liabilities

#### DEFERRED INCOME TAXES

LONG-TERM DEBT, less current maturities

DEFERRED COMPENSATION (Note 2)

#### OTHER NON-CURRENT LIABILITIES

#### STOCKHOLDERS' EQUITY:

5-1/2% convertible preferred stock, cumulative, voting without par value;  
 authorized 2,000,000 shares; issued 583,012 shares in 2002 and  
 583,252 shares in 2001  
 Common stock, \$1 par value; authorized 30,000,000 shares;  
 issued 9,718,709 shares in 2002 and 9,604,003 shares in 2001  
 Additional paid-in capital  
 Accumulated other comprehensive loss (Note 7)  
 Retained earnings (approximately \$34,750 unrestricted in 2002 and \$48,987 in 2001)  
 Less: Treasury stock shares of 856,284 in 2002 and 782,232 shares in 2001, at cost

Stockholders' equity

Total liabilities and stockholders' equity

\* See Note 3 for explanation of restatement.

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

STEPAN COMPANY  
 CONDENSED CONSOLIDATED STATEMENTS OF INCOME  
 For the Three and Six Months Ended June 30, 2002 and 2001  
 Unaudited

| (In thousands, except per share amounts) | Three Months Ended<br>June 30 |                      | Six Months<br>June 30 |
|--|-------------------------------|----------------------|-----------------------|
|  | 2002                          | 2001<br>As Restated* | 2002                  |
| NET SALES                                | \$ 188,795                    | \$ 182,767           | \$ 369,951            |
| Cost of Sales                            | 153,562                       | 153,066              | 305,749               |

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|   |           |           |           |
|---|-----------|-----------|-----------|
| Gross Profit  | 35,233    | 29,701    | 64,202    |
| Operating Expenses:   |           |           |           |
| Marketing   | 6,746     | 6,005     | 12,877    |
| Administrative  | 9,166     | 7,821     | 18,569    |
| Research, development and technical services                    | 5,986     | 5,793     | 11,972    |
|   | 21,898    | 19,619    | 43,418    |
| Operating Income  | 13,335    | 10,082    | 20,784    |
| Other Income (Expense):   |           |           |           |
| Interest, net   | (1,707)   | (1,757)   | (3,498)   |
| Income from equity joint venture                                | 1,166     | 493       | 1,654     |
|   | (541)     | (1,264)   | (1,844)   |
| Income Before Income Taxes                                      | 12,794    | 8,818     | 18,940    |
| Provision for Income Taxes                                      | 4,577     | 3,391     | 6,913     |
| NET INCOME  | \$ 8,217  | \$ 5,427  | \$ 12,027 |
| Net Income Per Common Share (Note 6):                           |           |           |           |
| Basic   | \$ 0.91   | \$ 0.59   | \$ 1.31   |
| Diluted   | \$ 0.84   | \$ 0.56   | \$ 1.23   |
| Shares Used to Compute Net Income Per<br>Common Share (Note 6): |           |           |           |
| Basic   | 8,859     | 8,850     | 8,847     |
| Diluted   | 9,803     | 9,746     | 9,772     |
| Dividends per Common Share                                      | \$ 0.1825 | \$ 0.1750 | \$ 0.3650 |

\* See Note 3 for explanation of restatement.

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

STEPAN COMPANY  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
For the Six Months Ended June 30, 2002 and 2001  
Unaudited

(Dollars in thousands)

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CASH FLOWS FROM OPERATING ACTIVITIES

Net income  
Depreciation and amortization  
Deferred revenue  
Deferred income taxes  
Environmental and legal liabilities  
Other non-cash items  
Changes in working capital:  
    Receivables, net  
    Inventories  
    Accounts payable and accrued liabilities  
    Other current assets

Net Cash Provided by Operating Activities

CASH FLOWS FROM INVESTING ACTIVITIES

Expenditures for property, plant and equipment  
Other non-current assets

Net Cash Used for Investing Activities

CASH FLOWS FROM FINANCING ACTIVITIES

Revolving debt and notes payable to banks, net  
Other debt borrowings  
Other debt repayments  
Purchase of treasury stock, net  
Dividends paid  
Stock option exercises  
Other

Net Cash Provided by Financing Activities

EFFECT OF EXCHANGE RATE CHANGES ON CASH

NET DECREASE IN CASH AND CASH EQUIVALENTS  
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD

CASH AND CASH EQUIVALENTS AT END OF PERIOD

CASH PAID DURING THE PERIOD FOR:

Interest  
  
Income taxes

\* See Note 3 for explanation of restatement.

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

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Unaudited

## 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The condensed consolidated financial statements included herein have been prepared by the Stepan Company (the "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 normal recurring adjustments necessary to present fairly the condensed consolidated financial position of the Company as of June 30, 2002, and the condensed consolidated results of operations for the three and six months then ended and cash flows for the six months then ended have been included.

## 2. DEFERRED COMPENSATION

The Company maintains deferred compensation plans. These plans allow management to defer receipt of their bonuses and directors to defer receipt of director fees until retirement or departure from the Company. The plans allow the participant to choose to invest in either Stepan common stock or a limited variety of mutual funds. These assets are owned by the Company and subject to the claims of general creditors of the Company. These plans are accounted for under the requirements of the consensus reached by the Emerging Issues Task Force ("EITF") of the Financial Accounting Standards Board ("FASB") in issue No. 97-14, "Accounting for Deferred Compensation Arrangements Where Amounts Earned are Held in a Rabbi Trust and Invested". A description of the Company's deferred compensation accounting policy follows:

The deferred compensation liability to the participants who elect deferral is recorded after the underlying compensation is earned, and recorded as expense. The purchase of Stepan common shares for the plans is recorded as a regular treasury stock purchase. The purchase of mutual funds is recorded as long term investments. Fluctuations in the value of these assets are recorded as adjustments to the deferred compensation liability and compensation costs included in administrative expense. The dividends, interest and capital gains from the mutual fund assets are recorded as investment income and included in "Other Income" as interest expense, net of investment income. Unrealized gains and losses resulting from market fluctuations of the mutual funds are recorded as other comprehensive income or expense in stockholders' equity.

## 3. RESTATEMENT

Subsequent to the issuance of its financial statements for the three month period ended March 31, 2002, management of the Company determined that the accounting treatment that had previously been afforded to the deferred compensation arrangements entered into with its managers and directors was not in accordance with the requirements of the consensus reached by the EITF of the FASB in issue No. 97-14, "Accounting for Deferred Compensation Arrangements Where Amounts Earned Are Held in a Rabbi Trust and Invested". This consensus requires that assets and liabilities of the deferred compensation plan be presented separately on the balance sheet; that fluctuations in asset values should result in compensation expense or income; and that, based on the categories of assets underlying the plan, investment income and expense should be recorded in the income statement

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and unrealized market appreciation should be reported as a component of other comprehensive income and included in stockholders' equity. Historically, the Company had recorded the assets and liabilities related to the plans on a net basis when the awards were made and did not recognize changes in asset value in income.

In addition, subsequent to the issuance of its financial statements for the periods ended June 30, 2002, the company determined that it had not recorded approximately \$3,429,000 in deferred income taxes related to the deferred compensation plan.

As a result, the condensed consolidated financial statements for the three and six months ended June 30, 2002 and 2001, and the year ended December 31, 2001, have been restated from the amounts previously reported. A summary of the significant effects of the restatement is as follows:

As of June 30, 2002:

| (Dollars in thousands)      | As<br>Previously<br>Reported<br>----- | Adjustments<br>----- | As Restated<br>----- |
|-----------------------------|---------------------------------------|----------------------|----------------------|
| <b>Assets</b>               |                                       |                      |                      |
| Deferred income taxes       | \$ 10,353                             | \$ (1,874)           | \$ 8,479             |
| <b>Liabilities</b>          |                                       |                      |                      |
| Deferred income taxes       | \$ 35,648                             | \$ (5,303)           | \$ 30,345            |
| <b>Stockholders' Equity</b> |                                       |                      |                      |
| Retained earnings           | \$ 149,624                            | \$ 3,429             | \$ 153,053           |

As of December 31, 2001:

| (Dollars in thousands)                        | As<br>Previously<br>Reported<br>----- | Adjust<br>----- |
|---|---------------------------------------|-----------------|
| <b>Assets</b>                                 |                                       |                 |
| Deferred income taxes                         | \$ 10,684                             | \$ (1           |
| Long term investments                         | -                                     | 7               |
| <b>Liabilities</b>                            |                                       |                 |
| Deferred income taxes                         | \$ 35,040                             | \$ (6           |
| Deferred compensation - current and long-term | -                                     | 17              |
| <b>Stockholders' Equity</b>                   |                                       |                 |
| Additional paid-in capital                    | \$ 16,893                             | \$              |
| Accumulated other comprehensive loss          | (14,800)                              | (1              |
| Retained earnings                             | 142,110                               | 2               |
| Treasury stock                                | (8,659)                               | (6              |

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For the three and six month periods ended June 30, 2001:

| (In thousands, except per share amounts)            | Three Months Ended June 30, 2001 |             |                | Six Months End               |      |
|---|----------------------------------|-------------|----------------|------------------------------|------|
|   | As<br>Previously<br>Reported     | Adjustments | As<br>Restated | As<br>Previously<br>Reported | Adju |
| Net income  | \$ 6,173                         | \$ (746)    | \$ 5,427       | \$ 9,801                     | \$   |
| Earnings per share:                                 |                                  |             |                |                              |      |
| Basic   | \$ 0.65                          | \$ (0.06)   | \$ 0.59        | \$ 1.02                      | \$   |
| Diluted   | 0.61                             | (0.05)      | 0.56           | 0.97                         |      |
| Shares used to compute net income per common share: |                                  |             |                |                              |      |
| Basic   | 9,264                            | (414)       | 8,850          | 9,253                        |      |
| Diluted   | 10,160                           | (414)       | 9,746          | 10,157                       |      |
| Other comprehensive income (loss)                   | \$ 505                           | \$ 263      | \$ 768         | \$ (1,006)                   | \$   |

#### 4. INVENTORIES

Inventories consist of following amounts:

| (Dollars in thousands)                       | June 30, 2002 |
|--|---------------|
| Inventories valued primarily on LIFO basis - |               |
| Finished products                            | \$ 40,491     |
| Raw materials                                | 21,465        |
| Total inventories                            | \$ 61,956     |

If the first-in, first-out (FIFO) inventory valuation method had been used for all inventories, inventory balances would have been approximately \$6.6 million and \$7.5 million higher than reported at June 30, 2002, and December 31, 2001, respectively.

#### 5. 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 federal Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA) and the Superfund amendments of 1986 ("Superfund"). The Company and others have been named as potentially responsible parties at affected geographic sites. As discussed in Management's Discussion and Analysis of Financial Condition and Results of Operations, the Company believes



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that it has made adequate provisions for the costs it may incur with respect to these sites. The Company has estimated a range of possible environmental and legal losses from \$7.2 million to \$34.3 million at June 30, 2002. At June 30, 2002 and December 31, 2001, the Company's reserve was \$17.0 million for legal and environmental matters.

For certain sites, estimates cannot be made of the total costs of compliance, or the Company's share of such costs; accordingly, the Company is unable to predict the effect thereof on future results of operations. In the event of one or more adverse determinations in any annual or interim period, the impact on results of operations for those periods could be material. However, based upon the Company's present belief as to its relative involvement at these sites, other viable entities' responsibilities for cleanup, and the extended period over which any costs would be incurred, the Company believes that these matters will not have a material effect on the Company's financial position. Following are summaries of the environmental proceedings related to the Company's Maywood, New Jersey, and Ewan and D'Imperio environmental sites:

### Maywood, New Jersey, Site

The Company's site in Maywood, New Jersey and property formerly owned by the Company adjacent to its current site, were listed on the National Priorities List in September 1993 pursuant to the provisions of the CERCLA because of certain alleged chemical contamination. Pursuant to an Administrative Order on Consent entered into between the United States Environmental Protection Agency (USEPA) and the Company for property formerly owned by the Company, and the issuance of an order by USEPA to the Company for property currently owned by the Company, the Company completed a Remedial Investigation Feasibility Study (RI/FS) in 1994. The Company submitted the Draft Final FS for Soil and Source Areas (Operable Unit 1) in September 2002. In addition, the Company has also submitted additional information regarding the remediation, most recently in October 2002. Discussions between USEPA and the Company are continuing. The Company is awaiting the issuance of a Record of Decision (ROD) from USEPA relating to the currently owned and formerly owned Company property and the proposed remediation. The final ROD will be issued sometime after the public comment period.

In 1985, the Company entered into a Cooperative Agreement with the United States of America represented by the Department of Energy (Agreement). Pursuant to this Agreement, the Department of Energy (DOE) took title to radiological contaminated materials and was to remediate, at its expense, all radiological waste on the Company's property in Maywood, New Jersey. The Maywood property (and portions of the surrounding area) were remediated by the DOE under the Formerly Utilized Sites Remedial Action Program, a federal program under which the U.S. Government undertook to remediate properties which were used to process radiological material for the U.S. Government. In 1997, responsibility for this clean-up was transferred to the United States Army Corps of Engineers (USACE). On January 29, 1999, the Company received a copy of a USACE Report to Congress dated January 1998 in which the USACE expressed their intention to evaluate, with the USEPA, whether the Company and/or other parties might be responsible for cost recovery or contribution claims related to the Maywood site. Subsequent to the issuance of that report, the USACE advised the Company that it had requested legal advice from the Department of Justice as to the impact of the Agreement.

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By letter dated July 28, 2000, the Department of Justice advised the Company that the USACE and USEPA had referred to the Justice Department claims against the Company for response costs incurred or to be incurred by the USACE, USEPA and the DOE in connection with the Maywood site and the Justice Department stated that the United States is entitled to recovery of its response costs from the Company under CERCLA. The letter referred to both radiological and non-radiological hazardous waste at the Maywood site and stated that the United States has incurred unreimbursed response costs to date of \$138 million. Costs associated with radiological waste at the Maywood site, which the Company believes represent all but a small portion of the amount referred to in the Justice Department letter, could be expected to aggregate substantially in excess of that amount. In the letter, the Justice Department invited the Company to discuss

settlement of the matter in order to avoid the need for litigation. The Company believes that its liability, if any, for such costs has been resolved by the aforesaid Agreement. Despite the fact that the Company continues to believe that it has no liability to the United States for such costs, discussions with the Justice Department are currently ongoing to attempt to resolve this matter.

The Company believes it has adequate reserves for claims associated with the Maywood site. However, depending on the results of the ongoing discussions regarding the Maywood site, the final cost of the remediation could differ from the current estimates.

### Ewan and D'Imperio Site

The Company has been named as a potentially responsible party (PRP) in the case USEPA v. Jerome Lightman (92 CV 4710 D. N. J.) which involves the Ewan and D'Imperio Superfund Sites located in New Jersey. Trial on the issue of the Company's liability at these sites was completed in March 2000. The Company is awaiting a decision from the court. If the Company is found liable at either site, a second trial as to the Company's allocated share of clean-up costs at these sites will likely be held in 2003. The Company believes it has adequate defenses to the issue of liability. In the event of an unfavorable outcome related to the issue of liability, the Company believes it has adequate reserves.

### Lightman Drum Site

The Company received a Section 104(e) Request for Information from USEPA dated March 21, 2000, regarding the Lightman Drum Company Site located in Winslow Township, New Jersey. The Company responded to this request on May 18, 2000. In addition, the Company received a Notice of Potential Liability and Request to Perform RI/FS dated June 30, 2000, from USEPA. The Company has decided that it will participate in the performance of the RI/FS. However, based on the current information known regarding this site, the Company is unable to predict what its liability, if any, will be for this site.

## 6. EARNINGS PER SHARE

Below is the computation of basic and diluted earnings per share for the three and six months ended June 30, 2002 and 2001.

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| (In thousands, except per share amounts)  | Three Months Ended<br>June 30 |                 | Six Months Ended<br>June 30 |                 |
|---|-------------------------------|-----------------|-----------------------------|-----------------|
|   | 2002                          | 2001            | 2002                        | 2001            |
| <u>Computation of Basic Earnings per Share</u>  |                               |                 |                             |                 |
| Net income  | \$ 8,217                      | \$ 5,427        | \$ 12,027                   | \$ 9,817        |
| Deduct dividends on preferred stock   | (200)                         | (200)           | (402)                       | (402)           |
| Income applicable to common stock   | <u>\$ 8,017</u>               | <u>\$ 5,227</u> | <u>\$ 11,625</u>            | <u>\$ 9,415</u> |
| Weighted-average number of common shares outstanding  | 8,859                         | 8,850           | 8,847                       | 8,847           |
| Basic earnings per share  | <u>\$ 0.91</u>                | <u>\$ 0.59</u>  | <u>\$ 1.31</u>              | <u>\$ 0.84</u>  |
| <u>Computation of Diluted Earnings per Share</u>  |                               |                 |                             |                 |
| Net income  | \$ 8,217                      | \$ 5,427        | \$ 12,027                   | \$ 9,817        |
| Weighted-average number of common shares outstanding  | 8,859                         | 8,850           | 8,847                       | 8,847           |
| Add net shares issuable from assumed exercise of options (under treasury stock method)      | 278                           | 230             | 259                         |                 |
| Add weighted-average shares issuable from assumed conversion of convertible preferred stock | 666                           | 666             | 666                         |                 |
| Shares applicable to diluted earnings   | <u>9,803</u>                  | <u>9,746</u>    | <u>9,772</u>                | <u>9,746</u>    |
| Diluted earnings per share  | <u>\$ 0.84</u>                | <u>\$ 0.56</u>  | <u>\$ 1.23</u>              | <u>\$ 0.84</u>  |

7. COMPREHENSIVE INCOME

Comprehensive income includes net income and all other non-owner changes in equity that are not reported in net income. Below is the Company's comprehensive income for the three and six months ended June 30, 2002 and 2001.

| (Dollars in thousands)                   | Three Months Ended<br>June 30 |          | Six Months Ended<br>June 30 |          |
|--|-------------------------------|----------|-----------------------------|----------|
|  | 2002                          | 2001     | 2002                        | 2001     |
| Net income                               | \$ 8,217                      | \$ 5,427 | \$ 12,027                   | \$ 9,817 |
| Other comprehensive income/(loss):       |                               |          |                             |          |
| Foreign currency translation adjustments | 1,156                         | 505      | (15)                        | (1,156)  |
| Unrealized gain/(loss) on securities     | (309)                         | 263      | (260)                       | (260)    |

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|                      |          |          |           |       |
|----------------------|----------|----------|-----------|-------|
| Comprehensive income | \$ 9,064 | \$ 6,195 | \$ 11,752 | \$ 7, |
|----------------------|----------|----------|-----------|-------|

At June 30, 2002, the total accumulated other comprehensive loss of \$16,145,000 was comprised of \$13,831,000 of foreign currency translation adjustments, \$1,330,000 of unrealized losses on securities and \$984,000 of minimum pension liability adjustments. At December 31, 2001, the total accumulated other comprehensive loss of \$15,870,000 included \$13,816,000 of foreign currency translation adjustments, \$1,070,000 of unrealized losses on securities and \$984,000 of minimum pension liability adjustments.

8. SEGMENT REPORTING

The Company has three reportable segments: surfactants, polymers and specialty products. There is no intersegment revenue and all intercompany transactions are eliminated from segments' revenue. Financial results of the Company's operating segments for the three and six months ended June 30, 2002 and 2001, are summarized below:

| (Dollars in thousands)                 | Surfactants | Polymers | Specialty<br>Products | Segment<br>Totals |
|--|-------------|----------|-----------------------|-------------------|
| For the quarter ended June 30, 2002    |             |          |                       |                   |
| Net sales                              | \$150,880   | \$31,183 | \$ 6,732              | \$188,795         |
| Operating income                       | 14,690      | 4,241    | 3,208                 | 22,139            |
| For the quarter ended June 30, 2001    |             |          |                       |                   |
| Net sales                              | \$140,408   | \$35,904 | \$ 6,455              | \$182,767         |
| Operating income                       | 10,435      | 5,770    | 2,203                 | 18,408            |
| For the six months ended June 30, 2002 |             |          |                       |                   |
| Net sales                              | \$297,696   | \$60,050 | \$12,205              | \$369,951         |
| Operating income                       | 26,979      | 8,394    | 4,320                 | 39,693            |
| For the six months ended June 30, 2001 |             |          |                       |                   |
| Net sales                              | \$280,786   | \$66,737 | \$12,101              | \$359,624         |
| Operating income                       | 20,351      | 9,692    | 3,183                 | 33,226            |

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

|                                     | Three Months Ended<br>June 30 |          | Six Months Ended<br>June 30 |           |
|-------------------------------------|-------------------------------|----------|-----------------------------|-----------|
|                                     | 2002                          | 2001     | 2002                        | 2001      |
| Operating income segment totals     | \$22,139                      | \$18,408 | \$39,693                    | \$ 33,226 |
| Unallocated corporate expenses/(a)/ | (8,804)                       | (8,326)  | (18,909)                    | (15,230)  |
| Interest expense                    | (1,707)                       | (1,757)  | (3,498)                     | (3,660)   |
| Equity in earnings of joint venture | 1,166                         | 493      | 1,654                       | 620       |

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|   |          |          |          |          |
|---|----------|----------|----------|----------|
| Consolidated income before income taxes | \$12,794 | \$ 8,818 | \$18,940 | \$ 14,95 |
|   | =====    | =====    | =====    | =====    |

/(a)/ Includes corporate administrative and corporate manufacturing expenses, which are not included in segment operating income and not used to evaluate segment performance.

9. GOODWILL AND OTHER INTANGIBLE ASSETS

On January 1, 2002, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets," which is effective for fiscal years beginning after December 15, 2001. This standard establishes new accounting and reporting requirements for goodwill and intangible assets including no amortization of goodwill, separate identification of certain identifiable intangible assets, and an annual assessment for impairment of all goodwill and intangible assets. The following is a reconciliation of the Company's reported net income, basic earnings per share and diluted earnings per share to the amounts that would have been reported had the new accounting rules been in effect at January 1, 2001:

| (In thousands, except per share data) | Three Months Ended<br>June 30 |          | Six Months Ended<br>June 30 |
|---------------------------------------|-------------------------------|----------|-----------------------------|
|                                       | 2002                          | 2001     | 2002                        |
| Reported net income                   | \$ 8,217                      | \$ 5,427 | \$ 12,027                   |
| Add back: Goodwill amortization       | -                             | 115      | -                           |
| Adjusted net income                   | \$ 8,217                      | \$ 5,542 | \$ 12,027                   |
|                                       | =====                         | =====    | =====                       |
| Basic earnings per share:             |                               |          |                             |
| Reported basic earnings per share     | \$ 0.91                       | \$ 0.59  | \$ 1.31                     |
| Add back: Goodwill amortization       | -                             | 0.01     | -                           |
| Adjusted basic earnings per share     | \$ 0.91                       | \$ 0.60  | \$ 1.31                     |
|                                       | =====                         | =====    | =====                       |
| Diluted earnings per share:           |                               |          |                             |
| Reported diluted earnings per share   | \$ 0.84                       | \$ 0.56  | \$ 1.23                     |
| Add back: Goodwill amortization       | -                             | 0.01     | -                           |
| Adjusted diluted earnings per share   | \$ 0.84                       | \$ 0.57  | \$ 1.23                     |
|                                       | =====                         | =====    | =====                       |

The Company's net carrying values of goodwill were \$6,187,000 and \$6,100,000 as of June 30, 2002 and December 31, 2001, respectively. The entire amount of goodwill relates to the surfactants' reporting unit.

SFAS No. 142 required the Company to complete a transition goodwill impairment test by comparing the fair value of the reporting unit with its net carrying value, including goodwill. The Company has completed this test and the results of that test indicated that goodwill was not impaired at January 1, 2002.

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The following table reflects the components of all other intangible assets, which have finite lives, as of June 30, 2002 and December 31, 2001.

| (In thousands)                       | Gross Carrying Amount |               | Accumulated   |
|--------------------------------------|-----------------------|---------------|---------------|
|                                      | June 30, 2002         | Dec. 31, 2001 | June 30, 2002 |
| Other Intangible Assets:             |                       |               |               |
| Patents                              | \$ 2,000              | \$ 2,000      | \$ 533        |
| Trademarks, customer lists, know-how | 17,095                | 17,095        | 5,984         |
| Non-compete Agreements               | 1,000                 | 1,000         | 1,000         |
| Total                                | \$ 20,095             | \$ 20,095     | \$ 7,517      |

Aggregate amortization expenses for the three and six months ended June 30, 2002, were \$332,000 and \$715,000, respectively. Aggregate amortization expenses for the three and six months ended June 30, 2001, were \$402,000 and \$805,000, respectively. Amortization expense is recorded based on useful lives ranging from 5 to 15 years. Estimated amortization expense for identifiable intangibles assets, other than goodwill, for each of the succeeding fiscal years are as follows:

(In thousands)

|                          |         |
|--------------------------|---------|
| For year ending 12/31/03 | \$1,330 |
| For year ending 12/31/04 | \$1,330 |
| For year ending 12/31/05 | \$1,330 |
| For year ending 12/31/06 | \$1,330 |
| For year ending 12/31/07 | \$1,086 |

### 10. RECENT ACCOUNTING PRONOUNCEMENTS

In June 2001, the FASB issued SFAS No. 141, "Business Combinations," effective for fiscal years beginning after December 15, 2001. It requires the use of the purchase method of accounting for all transactions initiated after June 30, 2001. The Company applied the provisions of SFAS No. 141 to the September 2001 acquisition of Manro Performance Chemicals Limited. No acquisitions took place during the first six months of 2002.

In April 2001, the EITF released Issue No. 00-25, "Vendor Income Statement Characterization of Consideration Paid to a Reseller of the Vendor's Products." Issue No. 00-25 provides guidance regarding the reporting of consideration given by a vendor to a reseller of the vendor's products. This issue requires certain considerations from vendor to a reseller of the vendor's products be viewed: (a) as a reduction of the selling prices of the vendor's products and, therefore, be recorded as a reduction of revenue when recognized in the vendor's income statement, or (b) as a cost incurred by the vendor for assets or services received from the reseller and, therefore, be recorded as a cost or an expense when recognized in the vendor's income statement. Issue No. 00-25 is effective

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for fiscal years beginning after December 15, 2001. The Company's accounting policies were consistent with the guidance provided in this issue. Therefore, the adoption of Issue No.00-25 did not have an impact on the Company's financial position or results of operations.

In June 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations". SFAS No. 143, which is effective for fiscal years beginning after June 15, 2002, supersedes previous guidance for financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The statement applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and/or the normal operation of a long-lived asset. The Company is evaluating the effect of this standard on its financial statements.

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". This statement addresses financial accounting and reporting for the impairment or disposal of long-lived assets and supersedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of." SFAS No. 144 was effective January 1, 2002. Adoption of this standard did not have an impact on the Company's financial position or results of operations.

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." The standard requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. SFAS No. 146 is to be applied prospectively to exit or disposal activities initiated after December 31, 2002. Based on the information currently available, adoption of this standard is not expected to have an impact on the Company's financial position or results of operations.

### 11. NEW CREDIT AND BANK TERM LOANS

During March 2002, the Company's Stepan Europe subsidiary completed an \$11.7 million (denominated in euros) bank term loan as long-term financing for a portion of the Manro acquisition. This loan will mature in seven years and bears interest at rates set quarterly, based on 90-day EURIBOR. The U.S. parent does not guaranty this loan.

In May 2002, the Company replaced its existing U.S. bank revolver with a new loan agreement. The new revolver will provide up to \$60 million of committed funding for general corporate purposes and may be drawn upon as needed through May 2, 2007. This arrangement provides for borrowings at various interest rates based, at the Company's option, on LIBOR plus a margin or at the bank's prime rate.

### 12. RECLASSIFICATIONS

Certain amounts in the 2001 financial statements have been reclassified to conform to the 2002 presentation.

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

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As discussed in Note 3 to the unaudited condensed consolidated financial statements, the Company has restated its financial statements for the three and six months periods ended June 30, 2002 and 2001 and for the year ended December 31, 2001. The accompanying Management's Discussion and Analysis gives effect to the restatement.

The following is management's discussion and analysis of certain significant factors, which have affected the Company's financial condition and results of operations during the interim period included in the accompanying condensed consolidated financial statements

### CRITICAL ACCOUNTING POLICIES

#### Estimates

We prepare our financial statements in accordance with accounting principles generally accepted in the United States of America. Preparing our financial statements in accordance with generally accepted accounting principles requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Critical areas where estimates are required are noted below:

#### Environmental Liabilities:

It is the Company's accounting policy to record environmental 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.

#### Reserves for Doubtful Accounts:

Accounts receivable are reported net of reserves for doubtful accounts. The Company determines the reserve requirement based upon the estimated collectibility of specific delinquent accounts, the Company's historical loss experience and the level of non-delinquent accounts receivable.

#### Reserves for Obsolete and Slow Moving Inventories:

The Company provides reserves for obsolete and slow moving inventory items. The reserve requirement is estimated based upon a review of specific inventory items that are identified as slow moving and consideration of potential salvage value and disposal costs.

Because the foregoing liabilities and reserves are recorded based on estimates, actual amounts could differ from these estimates.

#### Revenue Recognition

Revenue is recognized upon shipment of goods to customers. The Company records shipping and handling billed to a customer in a sales transaction as revenue. Costs incurred for shipping and handling are recorded in cost of sales. Volume discounts due customers are recognized as earned and reported as reductions of revenue in the statement of income.



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### Deferred Compensation

The Company maintains deferred compensation plans. These plans allow management to defer receipt of their bonuses and directors to defer receipt of director fees until retirement or departure from the Company. The plans allow the participant to choose to invest in either Stepan common stock or a limited variety of mutual funds. These assets are owned by the Company and subject to the claims of general creditors of the Company. Beginning in 2002, these plans are accounted for under the requirements of the consensus reached by the Emerging Issues Task Force ("EITF") of the Financial Accounting Standards Board ("FASB") in issue No. 97-14, "Accounting for Deferred Compensation Arrangements Where Amounts Earned are Held in a Rabbi Trust and Invested". As described in Note 3, prior period financial statements have been restated to correctly present the accounting for the Company's deferred compensation plans in accordance with EITF No. 97-14. A description of the Company's deferred compensation accounting policy follows:

The deferred compensation liability to the participants who elect deferral is recorded after the underlying compensation is earned, and recorded as expense. The purchase of Stepan common shares for the plans is recorded as a regular treasury stock purchase. The purchase of mutual funds is recorded as long term investments. Fluctuations in the value of these assets are recorded as adjustments to the deferred compensation liability and compensation costs included in administrative expense. The dividends, interest and capital gains from the mutual fund assets are recorded as investment income and included in "Other Income" as interest expense, net of investment income. Unrealized gains and losses resulting from market fluctuations of the mutual funds are recorded as other comprehensive income or expense in stockholders' equity.

### LIQUIDITY AND CAPITAL RESOURCES

Net cash from operating activities for the first six months of 2002 totaled \$13.4 million, an increase of \$1.4 million compared to \$12.0 million for the same period in 2001. A \$2.9 million increase in net income during the period was partially offset by increased working capital. For the first six months of 2002, seasonal working capital demands consumed \$21.5 million compared to a use of \$19.7 million for the same period last year. Working capital changes for the current year period include: accounts receivable up by \$15.2 million, inventories up by \$2.6 million, other current assets up by \$2.0 million and accounts payable and accrued liabilities down by \$1.7 million.

Capital spending totaled \$14.7 million for the first half of 2002, compared to \$17.2 million for the same period in 2001. Expenditures for property, plant and equipment are expected to be higher for the second half of 2002.

Consolidated debt increased by \$4.9 million during the first six months of 2002, from \$120.3 million to \$125.2 million. As of June 30, 2002, the ratio of long-term debt to long-term debt plus shareholders' equity was 41.5 percent, unchanged from December 31, 2001.

The Company maintains contractual relationships with its domestic banks that provide for revolving credit of up to \$60 million, which may be drawn upon as needed for general corporate purposes through May 2, 2007 under a new revolving credit agreement dated May 3, 2002. The Company also meets short-term liquidity requirements through uncommitted domestic bank lines of credit.

On May 3, 2002 the Company signed a new 5-year revolving credit agreement with three U.S. banks, including Bank One, N.A, Harris Trust and Savings Bank and Bank of America, N.A. This new facility replaces the previous revolving credit agreement and provides committed, unsecured funding of up to \$60 million for

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working capital, capital expenditures, acquisitions and other corporate purposes. The new agreement contains provisions substantially equivalent to the previous agreement, including limitations on additional debt, investments and payment of dividends.

The Company's foreign subsidiaries maintain committed and uncommitted bank lines of credit in their respective countries to meet working capital requirements as well as to fund capital expenditure programs and acquisitions. During March 2002, the Company's Stepan Europe subsidiary completed an \$11.7 million (denominated in euros) bank term loan as long-term financing for a portion of the Manro acquisition. This loan will mature in 7 years and bears interest at rates set quarterly, based on 90-day EURIBOR. The U.S. parent does not guaranty this loan.

The Company anticipates that cash from operations and from committed credit facilities will be sufficient to fund anticipated capital expenditures, dividends and other planned financial commitments for the foreseeable future. Any substantial acquisitions would require additional funding.

There have been no material changes in the Company's market risks since December 31, 2001.

### RESULTS OF OPERATIONS

Three Months Ended June 30, 2002 and 2001

Net income for the quarter ended June 30, 2002, increased 51 percent from \$5.4 million, or \$0.56 per diluted share in 2001 to \$8.2 million, or \$0.84 per diluted share in 2002. Net sales increased three percent to \$188.8 million in the second quarter of 2002 from \$182.8 million a year ago. Net sales by segment were:

| (Dollars in thousands) | Three Months<br>Ended June 30 |            |          |
|------------------------|-------------------------------|------------|----------|
|                        | 2002                          | 2001       | % Change |
| Net Sales:             |                               |            |          |
| Surfactants            | \$ 150,880                    | \$ 140,408 | +7       |
| Polymers               | 31,183                        | 35,904     | -13      |
| Specialty Products     | 6,732                         | 6,455      | +4       |
| Total                  | \$ 188,795                    | \$ 182,767 | +3       |
|                        | =====                         | =====      |          |

Surfactants net sales rose seven percent between years. Foreign operations accounted for the increase reporting an \$11.7 million, or 33 percent, increase in net sales due to a 44 percent growth in sales volume. Approximately \$11.2 million of the increase was due to the fourth quarter 2001 acquisition of Stepan UK. European operations, excluding Stepan UK, reported higher net sales due to increased sales volume and the favorable impact of a stronger euro. Canadian operations reported improved net sales due to increased sales volume coupled with higher average selling prices. Latin American operations posted decreased net sales due to lower sales volume and average selling prices.

Net sales for domestic U.S. operations, which accounted for 68 percent of total surfactant revenues, fell \$1.3 million, or one percent, to \$103.1 million in 2002 from \$104.4 million in 2001. A five percent drop in sales volume led to the net sales decline. Sales volumes for laundry and cleaning and distribution customers were down from quarter to quarter. The lower laundry and cleaning

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volumes were somewhat offset by increased personal care business.

Surfactants gross profit increased 29 percent to \$25.5 million in the second quarter of 2002 from \$19.9 million in the second quarter of 2001. Domestic operations reported a \$2.9 million, or 18 percent, increase in gross profit. The increase was due to higher margins, which more than offset the five percent drop in sales volume. Margins improved due to price decreases for major raw materials. Foreign operations' gross profit increased \$2.8 million, or 68 percent, from quarter to quarter. Stepan Europe contributed \$2.3 million to the improvement, of which \$1.7 million related to the previously noted Stepan UK acquisition. Canadian operations reported higher gross profit due to increased sales volume and improved margins, while Latin American operations reported lower gross profit primarily due to decreased sales volume.

Polymers net sales decreased \$4.7 million, or 13 percent, to \$31.2 million in the second quarter of 2002 from \$35.9 million in the second quarter of 2001. Phthalic Anhydride (PA) net sales increased \$1.4 million, or 17 percent, from quarter to quarter. A 50 percent rise in sales volume, due primarily to new business, accounted for the improvement. The increase was partially offset by a decline in average selling prices. Global polyurethane polyols net sales fell 22 percent to \$17.1 million for the second quarter of 2002 from \$22.0 million for the same period a year ago. Domestic operations accounted for most of the decline, reporting a \$5.1 million, or 26 percent, decrease in net sales due primarily to a 22 percent drop in sales volume. The volume drop

reflected a sluggish commercial roofing industry. Polyurethane systems net sales dropped 25 percent to \$4.0 million in the second quarter 2002 from \$5.3 million a year ago. Sales volume fell 26 percent due primarily to lost business.

Polymers second quarter 2002 gross profit was \$6.2 million, which was \$1.2 million, or 16 percent, below the \$7.4 million reported a year ago. Global polyurethane polyols' gross profit fell \$0.7 million, or 14 percent, to \$4.5 million in the second quarter of 2002 from \$5.2 million for the same period of 2001. Domestic operations gross profit declined \$0.9 million, or 17 percent, on a 22 percent decrease in sales volume. Improved margins partially offset the effect of the lower volume. Polyurethane systems gross profit decreased \$0.5 million, or 38 percent, from quarter to quarter. Lower sales volume and margins led to the decline. Higher unit overhead costs resulting from decreased production volumes led to the decreased average margin. PA's gross profit remained almost unchanged between quarters. The effect of increased sales volume was offset by decreased average margins.

Specialty products net sales rose four percent between years to \$6.7 million in the second quarter of 2002 from \$6.5 million in the second quarter of 2001. Increased sales to the pharmaceutical industry led to the improvement. Gross profit rose 41 percent to \$3.5 million in the second quarter of 2002 from \$2.5 million reported a year ago. Higher sales volume of higher margin products led to the growth.

Operating expenses for the second quarter of 2002 increased 12 percent to \$21.9 million from \$19.6 million for the same period a year ago. Administrative expenses increased \$1.3 million, or 17 percent, from quarter to quarter. The increase reflected \$1.9 million of expense related to the implementation of an enterprise resource planning system. The inclusion of \$0.6 million of expense related to Stepan UK, which was first consolidated in the fourth quarter of 2001, also contributed to the increase. A decline of \$0.9 million of deferred compensation expenses partially offset the increase. Marketing expenses rose \$0.7 million, or 12 percent, between quarters. The addition of Stepan UK marketing expenses coupled with an increase in domestic operations' bad debt provision accounted for most of the increase.

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Interest expenses declined three percent from quarter to quarter due to lower overall borrowing rates, partially offset by higher debt levels.

Income from the Philippines equity joint venture increased to \$1.2 million in the second quarter of 2002 from \$0.5 million in the second quarter of 2001. The rise was due to increased royalty income and to increased income generated by higher sales volume.

Six Months Ended June 30, 2002 and 2001

Net income for the six months ended June 30, 2002, was \$12.0 million, or \$1.23 per diluted share, up \$2.9 million, or 32 percent, from \$9.1 million, or \$0.94 per diluted share, for the same period in 2001. Net sales increased three percent to \$370.0 million from \$359.6 million reported last year. Net sales by segment were:

| (Dollars in thousands) | Six Months<br>Ended June 30 |            |                  |
|------------------------|-----------------------------|------------|------------------|
|                        | 2002                        | 2001       | % Chang<br>----- |
| Net Sales:             |                             |            |                  |
| Surfactants            | \$ 297,696                  | \$ 280,786 | +6               |
| Polymers               | 60,050                      | 66,737     | -10              |
| Specialty Products     | 12,205                      | 12,101     | +1               |
|                        | -----                       | -----      |                  |
| Total                  | \$ 369,951                  | \$ 359,624 | +3               |
|                        | =====                       | =====      |                  |

Surfactants net sales increased \$16.9 million, or six percent, to \$297.7 million in 2002 from \$280.8 million in 2001. Net sales for foreign operations rose \$21.2 million, or 31 percent, to \$89.9 million in the first half of 2002 from \$68.8 million in 2001. A 42 percent increase in sales volume caused the net sales growth. Approximately \$19.0 million of the increase was due to the fourth quarter 2001 acquisition of Stepan UK. Canadian operations reported a \$1.2 million, or six percent, rise in net sales due to improved sales volume, and Latin American operations posted a \$1.0 million, or six percent, increase in net sales due to higher average selling prices. European operations, excluding Stepan UK, reported almost unchanged net sales.

Domestic U.S. operations, which accounted for 70 percent of total surfactant revenues, reported a \$4.2 million, or two percent, decline in net sales to \$207.8 million in 2002 from \$212.0 million in 2001. A four percent drop in sales volume accounted for the decline. Volumes to laundry and cleaning and distribution customers were down from year to year.

Surfactants gross profit increased \$8.2 million, or 21 percent, to \$47.2 million in the first half of 2002 from \$39.0 million for the same period of 2001. Domestic operations reported a \$4.6 million, or 15 percent, increase in gross profit due to improved margins, which more than offset the impact of decreased volume. Decreased raw material costs led to the higher margins. Gross profit for foreign operations rose \$3.5 million, or 42 percent, to \$11.9 million in 2002 from \$8.4 million in 2001. Stepan Europe contributed \$3.1 million to the improvement, of which \$2.9 million related to the previously noted Stepan UK acquisition. Latin America operations reported higher gross profit due to improved margins.

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Polymers net sales decreased \$6.7 million, or 10 percent, to \$60.1 million in 2002 from \$66.8 million in 2001. Phthalic anhydride (PA) net sales increased 18 percent to \$19.9 million in 2002 from \$17.0 million in 2001. A 37 percent gain in sales volume, due primarily to new business, more than offset a drop in average selling prices. Lower raw material costs, which were passed on to customers, led to the average selling price decline. Global polyurethane polyols net sales fell 17 percent to \$32.7 million for the first half of 2002 from \$39.2 million for the same period of 2001. A 12 percent drop in sales volume led to the decline. Domestic operations accounted for most of the decline as net sales decreased \$6.5 million, or 19 percent, on a 16 percent drop in

sales volume. The volume drop reflected a sluggish economy. Urethane systems net sales fell 30 percent to \$7.4 million for the first half of 2002 from \$10.6 for the first half of 2001. A 29 percent drop in sales volume, due largely to lost business, caused the decrease.

Polymers gross profit was \$12.0 million for the first half of 2002, which was \$0.9 million, or seven percent, lower than gross profit for the same period of 2001. PA's gross profit increased \$0.6 million, or 31 percent, between years to \$2.6 million in 2002 from \$2.0 million in 2001. A 37 percent rise in sales volume more than offset a five percent drop in average margins. Global polyurethane polyols gross profit fell \$0.3 million, or four percent, to \$9.4 million in 2002 from \$9.7 million in 2001. Domestic operations gross profit declined \$0.7 million between years due to lower sales volume, partially offset by higher average margins. European gross profit increased \$0.5 million largely due to lower raw material costs. Polyurethane systems gross profit dropped 41 percent to \$1.5 million in 2002 from \$2.5 million in 2001. Lower sales volume and average margins led to the decrease. Higher unit overhead costs resulting from lower production volumes contributed to the decreased average margins.

Specialty products net sales increased \$0.1 million, or one percent, from year to year. The increase was primarily due to higher sales volume in the pharmaceutical industry. Gross profit rose \$1.4 million, or 37 percent, between years due to increased sales of higher margin products.

Operating expenses rose \$5.8 million, or 15 percent, to \$43.4 million in the first half of 2002 from \$37.6 million for the same period of 2001. Administrative expenses increased \$4.6 million, or 33 percent, between years. The increase reflected \$3.7 million of expense related to the implementation of an enterprise resource planning system. In addition, administrative expenses included deferred compensation expense of \$1.7 million, which was \$0.5 million higher than that of a year ago. The increase also reflected \$0.9 million of expense for Stepan UK, which was first consolidated in the fourth quarter of 2001. Salaries and related payroll costs fell \$1.3 million between years, partially offsetting the overall increase. Marketing expenses increased \$0.6 million, or five percent, between years. Research and development expenses increased \$0.5 million, or five percent, between years.

Interest expenses decreased four percent from year to year due to lower overall borrowing rates, partially offset by increased debt levels.

Income from the Philippines equity joint venture increased \$1.0 million between years due to increased royalty income and to increased income generated by higher sales volume.

### 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

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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 six months of 2002, Company

expenditures for capital projects related to the environment were \$0.7 million and should approximate \$1.2 million for the full year 2002. These projects are capitalized and typically depreciated over 10 years. Recurring costs associated with the operation and maintenance of facilities for waste treatment and disposal and managing environmental compliance in ongoing operations at our manufacturing locations were \$3.7 million for the first six months of 2002.

The Company has been named by the government as a potentially responsible party at 17 waste disposal sites where cleanup costs have been or may be incurred under the federal Comprehensive Environmental Response, Compensation and Liability Act 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. The Company has estimated a range of possible environmental and legal losses from \$7.2 million to \$34.3 million at June 30, 2002. At June 30, 2002 and December 31, 2001, the Company's reserve was \$17.0 million for legal and environmental matters. During the first six months of 2002, expenditures related to legal and environmental matters approximated \$1.5 million. For certain sites, estimates cannot be made of the total costs of compliance or the Company's share of such costs; accordingly, the Company is unable to predict the effect thereof on future results of operations. In the event of one or more adverse determinations in any annual or interim period, the impact on results of operations for those periods could be material. However, based upon the Company's present belief as to its relative involvement at these sites, other viable entities' responsibilities for cleanup and the extended period over which any costs would be incurred, the Company believes that these matters will not have a material effect on the Company's financial position.

### RECENT ACCOUNTING PRONOUNCEMENTS

In June 2001, the FASB issued SFAS No. 141, "Business Combinations," effective for fiscal years beginning after December 15, 2001. It requires the use of the purchase method of accounting for all transactions initiated after June 30, 2001. The Company applied the provisions of SFAS No. 141 to the September 2001 acquisition of Manro Performance Chemicals Limited. No acquisitions took place during the first six months of 2002.

In April 2001, the EITF released Issue No. 00-25, "Vendor Income Statement Characterization of Consideration Paid to a Reseller of the Vendor's Products." Issue No. 00-25 provides guidance regarding the reporting of consideration given by a vendor to a reseller of the vendor's products. This issue requires certain considerations from vendor to a reseller of the vendor's products be viewed: (a) as a reduction of the selling prices of the vendor's products and, therefore, be recorded as a reduction of revenue when recognized in the vendor's income statement, or (b) as a cost incurred by the vendor for assets or services received from the reseller and, therefore, be recorded as a cost or an expense when recognized in the vendor's income statement. Issue No. 00-25 is effective for fiscal years beginning after December 15, 2001. The Company's accounting policies were consistent with the guidance provided in this issue. Therefore, the adoption of Issue No.00-25 did not have an impact on the Company's financial position or results of operations.

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In June 2001, the FASB issued SFAS No. 143, "Accounting for Asset Retirement Obligations". SFAS No. 143, which is effective for fiscal years beginning after June 15, 2002, supersedes previous guidance for financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The statement applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and/or the normal operation of a long-lived asset. The Company is evaluating the effect of this standard on its financial statements.

In August 2001, the FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." This statement addresses financial accounting and reporting for the impairment or disposal of long-lived assets and supersedes SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of." SFAS No. 144 was effective January 1, 2002. Adoption of this standard did not have an impact on the Company's financial position or results of operations.

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### OTHER

Except for the historical information contained herein, the matters discussed in this document are forward looking statements that involve risks and uncertainties. The results achieved this quarter are not necessarily an indication of future prospects for the Company. Actual results in future quarters may differ materially. Potential risks and uncertainties include, among others, fluctuations in the volume and timing of product orders, changes in demand for the Company's products, changes in technology, continued competitive pressures in the marketplace, outcome of environmental contingencies, availability of raw materials, foreign currency fluctuations and the general economic conditions.

### Item 3 - Quantitative and Qualitative Disclosures about Market Risk

For information regarding our exposure to market risk, see the caption entitled "Liquidity and Capital Resources" in "Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations," which is incorporated herein by reference.

## Part II

### OTHER INFORMATION

#### Item 1 - Legal Proceedings

The Company's site in Maywood, New Jersey and property formerly owned by the Company adjacent to its current site, were listed on the National Priorities List in September 1993 pursuant to the provisions of the Comprehensive Environmental Response Compensation and Liability Act (CERCLA) because of certain alleged chemical contamination. Pursuant to an Administrative Order on

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Consent entered into between the United States Environmental Protection Agency (USEPA) and the Company for property formerly owned by the Company, and the issuance of an order by USEPA to the Company for property currently owned by the Company, the Company completed a Remedial Investigation Feasibility Study (RI/FS) in 1994. The Company submitted the Draft Final FS for Soil and Source Areas (Operable Unit 1) in September 2002. In addition, the Company has also submitted additional information regarding the remediation, most recently in October 2002. Discussions between USEPA and the Company are continuing. The Company is awaiting the issuance of a Record of Decision (ROD) from USEPA relating to the currently owned and formerly owned Company property and the proposed remediation. The final ROD will be issued sometime after the public comment period.

In 1985, the Company entered into a Cooperative Agreement with the United States of America represented by the Department of Energy (Agreement). Pursuant to this Agreement, the Department of Energy (DOE) took title to radiological contaminated materials and was to remediate, at its expense, all radiological waste on the Company's property in Maywood, New Jersey. The Maywood property (and portions of the surrounding area) were remediated by the DOE under the Formerly Utilized Sites Remedial Action Program, a federal program under which the U.S. Government undertook to remediate properties which were used to process radiological material for the U.S. Government. In 1997, responsibility for this clean-up was transferred to the United States Army Corps of Engineers (USACE). On January 29, 1999, the Company received a copy of a USACE Report to Congress dated January 1998 in which the USACE expressed their intention to evaluate, with the USEPA, whether the Company and/or other parties might be responsible for cost recovery or contribution claims related to the Maywood site. Subsequent to the issuance of that report, the USACE advised the Company that it had requested legal advice from the Department of Justice as to the impact of the Agreement.

By letter dated July 28, 2000, the Department of Justice advised the Company that the USACE and USEPA had referred to the Justice Department claims against the Company for response costs incurred or to be incurred by the USACE, USEPA and the DOE in connection with the Maywood site and the Justice Department stated that the United States is entitled to recovery of its response costs from the Company under CERCLA. The letter referred to both radiological and non-radiological hazardous waste at the Maywood site and stated that the United States has incurred unreimbursed response costs to date of \$138 million. Costs associated with radiological waste at the Maywood site, which the Company believes represent all but a small portion of the amount referred to in the Justice Department letter, could be expected to aggregate substantially in excess of that amount. In the letter, the Justice Department invited the Company to discuss settlement of the matter in order to avoid the need for litigation. The Company believes that its

liability, if any, for such costs has been resolved by the aforesaid Agreement. Despite the fact that the Company continues to believe that it has no liability to the United States for such costs, discussions with the Justice Department are currently ongoing to attempt to resolve this matter.

The Company believes it has adequate reserves for claims associated with the Maywood site. However, depending on the results of the ongoing discussions regarding the Maywood site, the final cost of the remediation could differ from the current estimates.

The Company has been named as a potentially responsible party (PRP) in the case USEPA v. Jerome Lightman (92 CV 4710 D. N. J.) which involves the Ewan and D'Imperio Superfund Sites located in New Jersey. Trial on the issue of the Company's liability at these sites was completed in March 2000. The Company is



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awaiting a decision from the court. If the Company is found liable at either site, a second trial as to the Company's allocated share of clean-up costs at these sites will likely be held in 2003. The Company believes it has adequate defenses to the issue of liability. In the event of an unfavorable outcome related to the issue of liability, the Company believes it has adequate reserves. On a related matter, the Company has filed an appeal to the United States Third Circuit Court of Appeals objecting to the lodging of a partial consent decree in favor of the United States Government in this action. Under the partial consent decree, the government recovered past costs at the site from all PRPs including the Company. The Company paid its assessed share but by objecting to the partial consent decree, the Company is seeking to recover back the sums it paid.

Regarding the D'Imperio Superfund Site, USEPA has indicated it will seek penalty claims against the Company based on the Company's alleged noncompliance with the modified Unilateral Administrative Order. The Company is currently negotiating with USEPA to settle its proposed penalty against the Company but does not believe that a settlement, if any, will have a material impact on the financial condition of the Company. In addition, the Company also received notice from the New Jersey Department of Environmental Protection (NJDEP) dated March 21, 2001, that NJDEP has indicated it will pursue cost recovery against the alleged responsible parties, including the Company. The NJDEP's claims include costs related to remediation of the D'Imperio Superfund Site in the amount of \$434,406 and alleged natural resource damages in the amount of \$529,584 (as of November 3, 2000). The NJDEP settled such claims against the alleged responsible parties, resulting in the Company paying its portion of \$83,061 in July 2002. This payment is subject to reallocation after the allocation phase of the above-identified trial, if any. The payment did not have a material impact on the financial condition of the Company.

The Company received a Section 104(e) Request for Information from USEPA dated March 21, 2000, regarding the Lightman Drum Company Site located in Winslow Township, New Jersey. The Company responded to this request on May 18, 2000. In addition, the Company received a Notice of Potential Liability and Request to Perform RI/FS dated June 30, 2000, from USEPA. The Company has decided that it will participate in the performance of the RI/FS. However, based on the current information known regarding this site, the Company is unable to predict what its liability, if any, will be for this site.

### Item 6 - Exhibits and Reports on Form 8-K

- (a) Exhibit 99.1 - Certification pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- (b) Reports on Form 8-K

Form 8-K reporting the effects of a change in accounting for deferred compensation plan as a correction of an error with restatement of the Company's three prior year financial statements has been filed on August 1, 2002.

### 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.

STEPAN COMPANY

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/s/ James E. Hurlbutt  
James E. Hurlbutt  
Vice President and Corporate Controller

Date: December 23, 2002

CERTIFICATIONS

I, F. Quinn Stepan, certify that:

1. I have reviewed this quarterly report on Form 10-Q/A of Stepan Company;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report.

Date: December 23, 2002

/s/ F. Quinn Stepan

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F. Quinn Stepan  
Chairman, Chief Executive Officer

CERTIFICATIONS

I, James E. Hurlbutt, certify that:

1. I have reviewed this quarterly report on Form 10-Q/A of Stepan Company;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report.

Date: December 23, 2002

/s/ James E. Hurlbutt

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James E. Hurlbutt  
Vice President & Corporate Controller