

STEPAN CO  
Form 10-Q  
July 29, 2011

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(MARK ONE)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934**

**FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2011**

**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)**

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**Delaware** **36-1823834**  
(State or other jurisdiction of **(I.R.S. Employer**  
**incorporation or organization)** **Identification Number)**  
**Edens and Winnetka Road, Northfield, Illinois 60093**

(Address of principal executive offices)

Registrant's telephone number (847) 446-7500

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

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

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

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

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

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

| Class                       | Outstanding at July 26, 2011 |
|-----------------------------|------------------------------|
| Common Stock, \$1 par value | 10,163,317 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 |            | Six Months Ended |            |
|--|--------------------|------------|------------------|------------|
|  | June 30            |            | June 30          |            |
|  | 2011               | 2010       | 2011             | 2010       |
| <b>Net Sales</b>   | \$ 476,989         | \$ 366,504 | \$ 899,587       | \$ 703,534 |
| Cost of Sales  | 407,404            | 303,026    | 768,216          | 576,504    |
| <b>Gross Profit</b>  | 69,585             | 63,478     | 131,371          | 127,030    |
| Operating Expenses:  |                    |            |                  |            |
| Marketing  | 12,171             | 9,391      | 23,001           | 20,342     |
| Administrative   | 12,680             | 14,273     | 23,554           | 23,336     |
| Research, development and technical services   | 10,656             | 10,042     | 20,887           | 19,925     |
|  | 35,507             | 33,706     | 67,442           | 63,603     |
| <b>Operating Income</b>  | 34,078             | 29,772     | 63,929           | 63,427     |
| Other Income (Expense):  |                    |            |                  |            |
| Interest, net  | (2,194)            | (1,510)    | (4,257)          | (2,766)    |
| Loss from equity in joint ventures   | (805)              | (764)      | (1,770)          | (1,335)    |
| Other, net (Note 14)   | 253                | (1,111)    | 565              | (1,333)    |
|  | (2,746)            | (3,385)    | (5,462)          | (5,434)    |
| <b>Income Before Provision for Income Taxes</b>  | 31,332             | 26,387     | 58,467           | 57,993     |
| Provision for Income Taxes   | 10,326             | 9,318      | 18,645           | 20,243     |
| <b>Net Income</b>  | 21,006             | 17,069     | 39,822           | 37,750     |
| Net Income Attributable to Noncontrolling Interests (Note 3)                                 | (139)              | (23)       | (194)            | (44)       |
| <b>Net Income Attributable to Stepan Company</b>   | \$ 20,867          | \$ 17,046  | \$ 39,628        | \$ 37,706  |
| Net Income Per Common Share Attributable to Stepan Company (Note 10):                        |                    |            |                  |            |
| Basic  | \$ 2.00            | \$ 1.66    | \$ 3.80          | \$ 3.69    |
| Diluted  | \$ 1.87            | \$ 1.53    | \$ 3.55          | \$ 3.41    |
| Shares Used to Compute Net Income Per Common Share Attributable to Stepan Company (Note 10): |                    |            |                  |            |
| Basic  | 10,345             | 10,160     | 10,335           | 10,130     |

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|                                     |         |         |         |         |
|-------------------------------------|---------|---------|---------|---------|
| Diluted                             | 11,178  | 11,118  | 11,175  | 11,052  |
| Dividends Declared Per Common Share | \$ 0.26 | \$ 0.24 | \$ 0.52 | \$ 0.48 |

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>  | June 30, 2011 | December 31, 2010 |
|--|---------------|-------------------|
| <b>Assets</b>  |               |                   |
| <b>Current Assets:</b>   |               |                   |
| Cash and cash equivalents  | \$ 25,599     | \$ 111,198        |
| Receivables, net   | 294,547       | 199,245           |
| Inventories (Note 7)   | 159,490       | 96,552            |
| Deferred income taxes  | 8,386         | 8,170             |
| Other current assets   | 16,570        | 12,661            |
| Total current assets   | 504,592       | 427,826           |
| <b>Property, Plant and Equipment:</b>  |               |                   |
| Cost   | 1,098,279     | 1,055,553         |
| Accumulated depreciation   | (729,513)     | (701,968)         |
| Property, plant and equipment, net   | 368,766       | 353,585           |
| Goodwill, net (Note 2)   | 7,289         | 6,717             |
| Other intangible assets, net (Note 2)  | 12,636        | 5,257             |
| Long-term investments (Note 4)   | 11,518        | 11,904            |
| Other non-current assets   | 6,124         | 6,142             |
| Total assets   | \$ 910,925    | \$ 811,431        |
| <b>Liabilities and Stockholders Equity</b>   |               |                   |
| <b>Current Liabilities:</b>  |               |                   |
| Current maturities of long-term debt (Note 13)   | \$ 35,809     | \$ 31,609         |
| Accounts payable   | 174,577       | 115,248           |
| Accrued liabilities  | 52,148        | 58,770            |
| Total current liabilities  | 262,534       | 205,627           |
| Deferred income taxes  | 9,986         | 5,154             |
| Long-term debt, less current maturities (Note 13)  | 154,956       | 159,963           |
| Other non-current liabilities  | 82,462        | 87,616            |
| <b>Commitments and Contingencies (Note 8)</b>  |               |                   |
| <b>Stockholders Equity:</b>  |               |                   |
| 5-1/2% convertible preferred stock, cumulative, voting, without par value; authorized 2,000,000 shares; issued and outstanding 520,089 shares in 2011 and 2010 | 13,002        | 13,002            |
| Common stock, \$1 par value; authorized 30,000,000 shares; issued 11,595,329 shares in 2011 and 11,511,829 shares in 2010                                      | 11,595        | 11,512            |
| Additional paid-in capital   | 88,238        | 83,852            |
| Accumulated other comprehensive loss   | (14,127)      | (25,599)          |

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|  |                |                |
|--|----------------|----------------|
| Retained earnings  | 339,820        | 305,830        |
| Treasury stock, at cost, 1,438,754 shares in 2011 and 1,406,081 shares in 2010 | (41,357)       | (39,106)       |
| <b>Total Stepan Company stockholders' equity</b>                               | <b>397,171</b> | <b>349,491</b> |
| Noncontrolling interests (Note 3)  | 3,816          | 3,580          |
| <b>Total stockholders' equity</b>  | <b>400,987</b> | <b>353,071</b> |
| Total liabilities and stockholders' equity                                     | \$ 910,925     | \$ 811,431     |

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>   | Six Months Ended June 30 |                 |
|---|--------------------------|-----------------|
|   | 2011                     | 2010            |
| <b>Cash Flows From Operating Activities</b>                                       |                          |                 |
| Net income  | \$ 39,822                | \$ 37,750       |
| Adjustments to reconcile net income to net cash provided by operating activities: |                          |                 |
| Depreciation and amortization   | 23,007                   | 19,288          |
| Deferred compensation   | (709)                    | 929             |
| Realized and unrealized loss (gain) on long-term investments                      | (438)                    | 367             |
| Stock-based compensation  | 1,777                    | 1,806           |
| Deferred income taxes   | 4,846                    | 3,823           |
| Other non-cash items  | 1,083                    | 1,627           |
| Changes in assets and liabilities:  |                          |                 |
| Receivables, net  | (83,875)                 | (61,722)        |
| Inventories   | (55,088)                 | (13,745)        |
| Other current assets  | (3,586)                  | (935)           |
| Accounts payable and accrued liabilities  | 55,151                   | 27,793          |
| Pension liabilities   | (895)                    | (488)           |
| Environmental and legal liabilities   | (412)                    | (847)           |
| Deferred revenues   | (890)                    | (596)           |
| Excess tax benefit from stock options and awards                                  | (1,113)                  | (2,076)         |
| <b>Net Cash Provided By (Used In) Operating Activities</b>                        | <b>(21,320)</b>          | <b>12,974</b>   |
| <b>Cash Flows From Investing Activities</b>                                       |                          |                 |
| Expenditures for property, plant and equipment                                    | (40,400)                 | (28,007)        |
| Business acquisition  | (13,562)                 |                 |
| Sale of mutual funds  | 1,613                    | 737             |
| Other, net  | (2,136)                  | (1,639)         |
| <b>Net Cash Used In Investing Activities</b>                                      | <b>(54,485)</b>          | <b>(28,909)</b> |
| <b>Cash Flows From Financing Activities</b>                                       |                          |                 |
| Revolving debt and bank overdrafts, net   | 9,738                    | 3,124           |
| Term loan   |                          | 40,000          |
| Build-to-suit obligation buyout   | (12,206)                 |                 |
| Other debt borrowings   |                          | 440             |
| Other debt repayments   | (2,291)                  | (2,532)         |
| Dividends paid  | (5,638)                  | (5,170)         |
| Company stock repurchased   | (1,000)                  | (3,750)         |
| Stock option exercises  | 889                      | 3,109           |
| Excess tax benefit from stock options and awards                                  | 1,113                    | 2,076           |
| Other, net  | (1,265)                  | (1,273)         |
| <b>Net Cash Provided By (Used In) Financing Activities</b>                        | <b>(10,660)</b>          | <b>36,024</b>   |
| Effect of Exchange Rate Changes on Cash   | 866                      | (765)           |
| <b>Net Increase (Decrease) in Cash and Cash Equivalents</b>                       | <b>(85,599)</b>          | <b>19,324</b>   |
| Cash and Cash Equivalents at Beginning of Period                                  | 111,198                  | 98,518          |

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|  |           |            |
|--|-----------|------------|
| Cash and Cash Equivalents at End of Period | \$ 25,599 | \$ 117,842 |
|--|-----------|------------|

**Supplemental Cash Flow Information**

|   |          |           |
|---|----------|-----------|
| Cash payments of income taxes, net of refunds | \$ 9,832 | \$ 13,930 |
|---|----------|-----------|

|                           |          |          |
|---------------------------|----------|----------|
| Cash payments of interest | \$ 4,122 | \$ 2,778 |
|---------------------------|----------|----------|

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



STEPAN COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2011

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 June 30, 2011 and its results of operations for the three and six months ended June 30, 2011 and 2010, and cash flows for the six months ended June 30, 2011 and 2010, 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 2010 Form 10-K.

2. ACQUISITION

On June 23, 2011, the Company purchased the Clarinol®, Marinol®, and PinnoThin® product lines of Lipid Nutrition B.V., a part of Loders Croklaan B.V. The acquired product lines will be integrated into the Company's specialty products segment and will be combined with existing Company food and health services products to provide the Company with a unique portfolio of nutritional fats for the global food, supplement and nutrition industries. The acquisition purchase price was \$13,562,000 of cash. In addition to the purchase price paid, the Company incurred \$0.3 million of acquisition-related costs, including legal and consulting expenses. These costs were reflected in administrative expenses on the Company's statements of income.

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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>(Dollars in thousands)</i>               | June 23, 2011    |
|---|------------------|
| <b>Assets:</b>                              |                  |
| Inventory                                   | \$ 5,000         |
| <b>Identifiable intangible assets:</b>      |                  |
| Patents                                     | 6,948            |
| Customer lists                              | 736              |
| Trademarks, know-how                        | 429              |
| <b>Total identifiable intangible assets</b> | <b>8,113</b>     |
| Goodwill                                    | 483              |
| <b>Total assets acquired</b>                | <b>\$ 13,596</b> |
| Current liabilities                         | \$ 34            |
| <b>Net assets acquired</b>                  | <b>\$ 13,562</b> |

The acquired goodwill, which relates entirely to the Company's specialty products segment, is deductible for tax purposes. The goodwill reflects the potential manufacturing and marketing synergies arising from combining the new product lines with the Company's existing food and health services products. The weighted average amortization periods for the identifiable intangible assets are as follows: patents- 12 years; customer lists-five years; and trademarks and know-how- five years. The Company continues to evaluate the valuations of the acquired intangible assets, which may result in adjustments to the recorded values of the intangible assets and goodwill.

Due to the timing of the purchase transaction relative to the end of the reporting period, no post-acquisition financial results for the new business were included in the Company's consolidated financial statements for the three and six month periods ended June 30, 2011. Pro forma financial information has not been included because revenues and earnings of the Company's consolidated entity for the three and six month periods ended June 30, 2011 and 2010, would not have been materially different than reported had the acquisition date been January 1, 2010.

3. RECONCILIATIONS OF EQUITY

Below are reconciliations of total equity, Company equity and equity attributable to the noncontrolling interests for the six months ended June 30, 2011 and 2010:

| <i>(In thousands)</i>                           | Total<br>Equity | Stepan<br>Company<br>Equity | Noncontrolling<br>Interests<br>Equity <sup>(3)</sup> |
|---|-----------------|-----------------------------|--|
| Balance at January 1, 2011                      | \$ 353,071      | \$ 349,491                  | \$ 3,580   |
| Net income                                      | 39,822          | 39,628                      | 194  |
| Dividends                                       | (5,638)         | (5,638)                     |  |
| Common stock purchases <sup>(1)</sup>           | (2,274)         | (2,274)                     |  |
| Stock option exercises                          | 889             | 889                         |  |
| Defined benefit pension adjustments, net of tax | 1,044           | 1,044                       |  |
| Translation adjustments                         | 10,081          | 10,039                      | 42   |
| Derivative instrument gain, net of tax          | 389             | 389                         |  |
| Other <sup>(2)</sup>                            | 3,603           | 3,603                       |  |
| <br>Balance at June 30, 2011                    | <br>\$ 400,987  | <br>\$ 397,171              | <br>\$ 3,816   |

| <i>(In thousands)</i>                           | Total Equity          | Stepan<br>Company<br>Equity | Noncontrolling<br>Interests<br>Equity <sup>(3)</sup> |
|---|-----------------------|-----------------------------|--|
| <b>Balance at January 1, 2010</b>               | <b>\$ 290,427</b>     | <b>\$ 289,285</b>           | <b>\$ 1,142</b>                                      |
| Net income                                      | 37,750                | 37,706                      | 44   |
| Dividends                                       | (5,170)               | (5,170)                     |  |
| Common stock purchases <sup>(1)</sup>           | (4,807)               | (4,807)                     |  |
| Stock option exercises                          | 3,109                 | 3,109                       |  |
| Defined benefit pension adjustments, net of tax | 756                   | 756                         |  |
| Translation adjustments                         | (8,674)               | (8,674)                     |  |
| Other <sup>(2)</sup>                            | 4,221                 | 4,221                       |  |
| <br><b>Balance at June 30, 2010</b>             | <br><b>\$ 317,612</b> | <br><b>\$ 316,426</b>       | <br><b>\$ 1,186</b>                                  |

<sup>(1)</sup> 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.

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

<sup>(3)</sup> 2011 includes partners' noncontrolling interests in the Company's China and Philippines joint ventures. 2010 includes partners' noncontrolling interest in the China joint venture.

4. FINANCIAL INSTRUMENTS

The following are the financial instruments held by the Company at June 30, 2011 and December 31, 2010, and descriptions of 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 contracts discussed in Note 5. Fair value and carrying value are the same because the contracts are recorded at fair value. The fair values of the foreign currency contracts were calculated as the differences between the applicable forward foreign exchange rates at the reporting date and the contracted foreign exchange rates multiplied by the contracted notional amounts. See the table that follows these 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. Fair value and carrying value are the same because the mutual fund assets are recorded at fair value. 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 these financial instrument descriptions for the reported fair value of long-term investments.

*Debt obligations*

The Company's primary source of long-term U.S. debt financing is unsecured private placement notes with fixed interest rates and maturities. Certain foreign subsidiaries also carry fixed-rate debt. The fair value of fixed interest rate debt comprises 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 discount rates are based on applicable duration funding rates plus market interest rate spreads to borrowers with credit ratings equivalent to those of the Company. The fair values of the Company's fixed-rate debt at June 30, 2011 and December 31, 2010, including current maturities, were estimated to be \$123,436,000 and \$122,044,000, respectively. The carrying value of the Company's fixed-rate debt was \$113,045,000 at June 30, 2011 and \$113,359,000 at December 31, 2010.

The Company's Singapore facility also holds fixed-rate debt in the form of a seller note (related to the 2010 purchase of storage tanks), which had an estimated fair value of \$14,458,000 at June 30, 2011, compared to a carrying value of \$13,843,000. At December 31, 2010, the fair value of the seller note approximated its carrying value of \$13,008,000.

Debt at June 30, 2011 also included \$25,500,000 for an unsecured term loan that carried a variable interest rate of LIBOR plus a spread of 100 basis points as of June 30, 2011. As of the end of the second quarter, the current market spread over LIBOR for entities with credit ratings similar to the Company's was approximately 200 basis points. Using the current market spread to discount the scheduled principal and interest payment outflows calculated under the contractual spread, the Company estimates the fair value of the variable interest unsecured term loan at June 30, 2011, at approximately \$25,018,000 compared to a carrying value of \$25,500,000. At December 31, 2010, the fair value of the variable interest unsecured term loan was \$26,390,000 compared to a carrying value of \$27,000,000.

Also included in debt as of June 30, 2011 was \$8,783,000 of term debt of the Company's Philippine subsidiary, comprised of two bank loans guaranteed by the U.S. parent. Using the current market spread for loans to companies with credit ratings similar to the Company's to discount the scheduled principal and interest payment outflows calculated under the contractual spreads, the Company estimates the combined fair value of these variable interest secured term loans at June 30, 2011, to be approximately \$9,038,000 versus a carrying value of \$8,783,000. At December 31, 2010, the fair value of these term loans was \$9,028,000 compared to a carrying value of \$8,805,000.

Because of the short-term nature of the remaining Company debt, the fair values for such debt approximate the carrying values.

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The following tables present financial assets and liabilities measured at fair value as of June 30, 2011 and December 31, 2010 and the level within the fair value hierarchy in which the fair value measurements fall:

| <i>(In thousands)</i>                  | June<br>2011 | Level 1   | Level 2 | Level 3 |
|--|--------------|-----------|---------|---------|
| Mutual fund assets                     | \$ 11,518    | \$ 11,518 | \$      | \$      |
| Derivative assets: <sup>(1)</sup>      |              |           |         |         |
| Foreign currency contracts             | 765          |           | 765     |         |
| Total assets at fair value             | \$ 12,283    | \$ 11,518 | \$ 765  | \$      |
| Derivative liabilities: <sup>(1)</sup> |              |           |         |         |
| Foreign currency contracts             | \$ 321       | \$        | \$ 321  | \$      |
| Total liabilities at fair value        | \$ 321       | \$        | \$ 321  | \$      |

| <i>(In thousands)</i>                  | December<br>2010 | Level 1   | Level 2 | Level 3 |
|--|------------------|-----------|---------|---------|
| Mutual fund assets                     | \$ 11,904        | \$ 11,904 | \$      | \$      |
| Derivative assets: <sup>(1)</sup>      |                  |           |         |         |
| Foreign currency contracts             | 30               |           | 30      |         |
| Total assets at fair value             | \$ 11,934        | \$ 11,904 | \$ 30   | \$      |
| Derivative liabilities: <sup>(1)</sup> |                  |           |         |         |
| Foreign currency contracts             | \$ 43            | \$        | \$ 43   | \$      |
| Total liabilities at fair value        | \$ 43            | \$        | \$ 43   | \$      |

<sup>(1)</sup> See Note 5 for the balance sheet locations of the derivative assets and liabilities

#### 5. 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 (although they are effectively economic hedges). 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 June 30, 2011, and December 31,

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2010, the Company had open forward foreign currency exchange contracts, with settlement dates ranging from one month to approximately 30 months, to buy or sell foreign currencies with a U.S. dollar equivalent of \$55,982,000 and \$25,014,000, respectively.

The Company also holds forward foreign currency exchange contracts that are designated as a cash flow hedge. The Company uses these contracts to manage the risks and related cash flow variability resulting from exposure to exchange rate fluctuations on forecasted progress payments related to a construction project undertaken in Singapore. The progress payments are denominated in a currency other than the Singapore location's functional currency. The latest date through which the Company expects to hedge its exposure to the variability in cash flows for the progress payments is December 31, 2013. The forward foreign exchange contracts are recognized on the balance sheet as either an asset or a liability measured at fair value. Period-to-period changes in the fair value of the hedging instruments are recognized in other comprehensive income, to the extent effective. Once the constructed asset is complete and placed into service, the accumulated gains and losses will be reclassified out of accumulated other comprehensive income (AOCI) into earnings in the periods over which the asset is being depreciated. No reclassifications of gains and losses from AOCI were made into earnings in the three and six month periods ended June 30, 2011. Assuming the construction project is completed on time, less than \$10,000 of the amount currently in AOCI is expected to be reclassified into earnings in the next 12 months. At June 30, 2011, the Company had an open forward foreign currency exchange contract designated as a cash flow hedge with a U.S. dollar equivalent amount of \$10,268,000. No such contracts were held at December 31, 2010.

The fair values of the derivative instruments held by the Company on June 30, 2011, and December 31, 2010, were as follows:

| <i>(In thousands)</i>         | Asset Derivatives        |               |                   | Liability Derivatives |               |                   |
|-------------------------------|--------------------------|---------------|-------------------|-----------------------|---------------|-------------------|
|                               | Balance Sheet            | Fair Value At |                   | Balance Sheet         | Fair Value At |                   |
| Derivatives Designated        | Line Item                | June 30, 2011 | December 31, 2010 | Line Item             | June 30, 2011 | December 31, 2010 |
| As Hedging Instruments        |                          |               |                   |                       |               |                   |
| Foreign Exchange Contracts    | Receivables, net         | \$ 106        | \$                | Accounts payable      | \$            | \$                |
| Derivatives Not Designated    |                          |               |                   |                       |               |                   |
| As Hedging Instruments        |                          |               |                   |                       |               |                   |
| Foreign Exchange Contracts    | Receivables, net         | \$ 174        | \$ 30             |                       |               |                   |
| Foreign Exchange Contracts    | Other non-current assets | 485           |                   | Accounts payable      | \$ 321        | \$ 43             |
| Total Non-hedging Derivatives |                          | \$ 659        | \$ 30             |                       | \$ 321        | \$ 43             |
| Total Derivatives             |                          | \$ 765        | \$ 30             |                       | \$ 321        | \$ 43             |

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Information regarding derivative instrument gains and losses for the three and six month periods ended June 30, 2011 and 2010 is displayed below:

| Derivatives Not Designated                | Income Statement | Gain (Loss)                |                 |                          |                 |
|---|------------------|----------------------------|-----------------|--------------------------|-----------------|
|   |                  | Three Months ended June 30 |                 | Six Months ended June 30 |                 |
| As Hedging Instruments                    | Line Item        | 2011                       | 2010            | 2011                     | 2010            |
| Foreign currency contracts                | Other, net       | \$ 138                     | \$ (1,524)      | \$ 423                   | \$ (744)        |
| Forward electric contracts <sup>(1)</sup> | Cost of sales    |                            | 616             |                          | 369             |
| <b>Total</b>                              |                  | <b>\$ 138</b>              | <b>\$ (908)</b> | <b>\$ 423</b>            | <b>\$ (375)</b> |

<sup>(1)</sup> During 2010, the Company held forward electric contracts to purchase 107,000 megawatts of electricity at fixed prices in 2010. The Company entered into the contracts to help manage the volatile cost of electricity. The electric contracts were considered derivative instruments and did not qualify for the normal purchase election. The contracts expired on December 31, 2010. No such contracts were held on June 30, 2011, or at any time during the three and six month periods then ended.

| (In thousands)<br>Derivatives Designated | Gain Recognized in Other Comprehensive Income | Income Statement Line Item for Loss Due to Ineffectiveness or Exclusion From Effectiveness Testing | Loss Due to Ineffectiveness or Exclusion From Effectiveness Testing <sup>(1)</sup> |                            |
|--|---|--|--|----------------------------|
|  |   |  | Three Months ended June 30   | Three Months ended June 30 |
| As Cash Flow Hedges                      | 2011  | 2010   | 2011   | 2010                       |
| Foreign Exchange Contracts               | \$ 315  | Other, net   | \$ (10)  | \$                         |

| (In thousands)<br>Derivatives Designated | Gain Recognized in Other Comprehensive Income | Income Statement Line Item for Loss Due to Ineffectiveness or Exclusion From Effectiveness Testing | Loss Due to Ineffectiveness or Exclusion From Effectiveness Testing <sup>(1)</sup> |                          |
|--|---|--|--|--------------------------|
|  |   |  | Six Months ended June 30   | Six Months ended June 30 |
| As Cash Flow Hedges                      | 2011  | 2010   | 2011   | 2010                     |
| Foreign Exchange Contracts               | \$ 389  | Other, net   | \$ (11)  | \$                       |

<sup>(1)</sup> The loss was entirely attributable to the component of the foreign currency exchange contracts that was excluded from the assessment of hedge effectiveness.



**6. STOCK-BASED COMPENSATION**

On June 30, 2011, the Company had stock options outstanding under its 2000 Stock Option Plan (2000 Plan) and stock options and stock awards outstanding under its 2006 Incentive Compensation Plan. Compensation expense charged against income for all stock options and awards was \$928,000 and \$1,777,000 for the three and six months ended June 30, 2011, compared to \$934,000 and \$1,806,000, respectively, for the three and six months ended June 30, 2010. Unrecognized compensation cost for stock options and stock awards was \$1,774,000 and \$3,183,000, respectively, at June 30, 2011, compared to \$972,000 and \$2,234,000, respectively, at December 31, 2010. The increase in unrecognized compensation cost was due to 2011 grants of 61,423 stock options and 28,495 stock awards. The unrecognized compensation cost at June 30, 2011 is expected to be recognized over weighted average periods of 1.3 years and 2.0 years for stock options and stock awards, respectively.

**7. INVENTORIES**

The composition of inventories was as follows:

| <i>(In thousands)</i>    | June 30, 2011     | December 31, 2010 |
|--------------------------|-------------------|-------------------|
| Finished products        | \$ 101,307        | \$ 62,685         |
| Raw materials            | 58,183            | 33,867            |
| <b>Total inventories</b> | <b>\$ 159,490</b> | <b>\$ 96,552</b>  |

Inventories are primarily priced 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 \$41,306,000 and \$34,280,000 higher than reported at June 30, 2011, and December 31, 2010, respectively.

**8. 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.

The Company has estimated a range of possible environmental and legal losses of \$9.4 million to \$29.2 million at June 30, 2011. At June 30, 2011 and December 31, 2010, 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 \$15.9 million, respectively. Actual costs could differ from the estimated reported liability. During the first six months of 2011 cash outlays related to legal and environmental matters approximated \$2.7 million compared to \$1.6 million in the first six months of 2010. Remediation of the soil at the Poland subsidiary accounted for most of the year-over-year change (see the Poland Manufacturing Site discussion in this footnote).

For certain sites, estimates of the total costs of compliance or the Company's share of such costs cannot be determined; consequently, the Company is unable to predict the effect thereof on the Company's financial position, cash flows and results of operations. Management believes that in the event of one or more adverse determinations in any annual or interim period, the impact on the Company's cash flows and 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, individually and in the aggregate, will not have a material effect on the Company's financial position.

Following are summaries of the material contingencies at June 30, 2011:

***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 completed a Remedial Investigation Feasibility Study (RI/FS) in 1994. The Company submitted the Draft Feasibility Study for Soil and Source Areas (Operable Unit 1) in September 2002. In addition, the Company has submitted other documentation and information as requested by USEPA, including a Draft Final FS for Groundwater (Operable Unit 2) in June 2003, additional information regarding groundwater in May 2007, submission of a Draft Feasibility Study for Soil and Groundwater (Operable Units 1 and 2) in March 2009, and additional requested information regarding soil and groundwater in February 2010 and June 2010. The Company also submitted another Draft Feasibility Study for Soil and Groundwater (Operable Units 1 and 2) in September 2010. The Company is awaiting the issuance of a Record of Decision from USEPA.

The Company believes its recorded liability for the estimated probable costs it expects to incur at the Maywood site related to remediation of chemical contamination is adequate. However, depending on the results of the ongoing discussions with USEPA, the final cost of such remediation could differ from the current estimates.

***D Imperio Property Site***

During the mid-1970 s, Jerome Lightman and the Lightman Drum Company disposed of hazardous substances at several sites in New Jersey. The Company was named as a PRP in the case *United States v. Lightman* (1:92-cv-4710 D.N.J.), which involved the D Imperio Property Site located in New Jersey. In the second quarter of 2007, the Company reached an agreement with respect to the past costs and future allocation percentage in said litigation for costs related to the D Imperio site, including costs to comply with USEPA s Unilateral Administrative Orders. The Company paid the settlement amount in the third quarter of 2007. The resolution of the Company s liability for this litigation did not have a material impact on the financial position, results of operations or cash flows of the Company. In December 2007, the Company received updated remediation cost estimates, which were considered in the Company s determination of its range of estimated possible losses and reserve balance.

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 \$1.9 million for the Company s portion of environmental response costs through the first quarter of 2011 (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.

In addition, in response to the special notice letter received by the PRPs in June 2006 from USEPA seeking performance of an RI/FS at the site, certain PRPs, including the Company, signed an Administrative Settlement Agreement and Order on Consent for the RI/FS effective July 2007, which sets forth the obligations of the PRPs to perform the RI/FS.

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

The Company believes that based on current information its recorded liability for the claims related to this site is adequate. However, actual costs could differ from current estimates.

*Poland Manufacturing Site*

During the due diligence phase of the Company's 2010 acquisition of Alfa Systems Sp. z o.o. (Alfa Systems) in Brzeg Dolny, Poland, some soil contamination in levels above allowable standards in Poland was discovered on the plant site, and there is a legal obligation to conduct further investigation and remediation. To expedite the purchase of Alfa Systems, the Company agreed to assume the remediation obligation. As part of the purchase agreement, the Company negotiated a purchase price holdback provision of \$1.1 million, wherein any portion of the holdback not spent for soil remediation after one year following the acquisition date (i.e., July 15, 2011) would be remitted to the previous owners of Alfa Systems. A remediation liability was included as one of the liabilities assumed at the time of acquisition. No contingent consideration liability was recognized because management believed it was highly probable that remediation of the Poland site would be completed by the holdback deadline and the cost to remediate would be at least the holdback amount. The remediation of the soil was completed in the second quarter of 2011, and the total cost of the project exceeded the amount of the holdback provision by an immaterial amount. Consequently, none of the holdback amount related to the soil remediation was returned to the former owners of the site. The amount in excess of the holdback amount was charged to Company earnings, and did not have a material effect on the Company's results of operations, financial position or cash flows.

9. POSTRETIREMENT BENEFIT PLANSDefined 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>          | <b>UNITED STATES</b> |          |                  |          |
|--------------------------------|----------------------|----------|------------------|----------|
|                                | Three Months Ended   |          | Six Months Ended |          |
|                                | June 30              |          | June 30          |          |
|                                | 2011                 | 2010     | 2011             | 2010     |
| Interest cost                  | \$ 1,761             | \$ 1,767 | \$ 3,523         | \$ 3,534 |
| Expected return on plan assets | (2,013)              | (1,962)  | (4,025)          | (3,924)  |
| Amortization of net loss       | 786                  | 535      | 1,571            | 1,070    |
| Net periodic benefit cost      | \$ 534               | \$ 340   | \$ 1,069         | \$ 680   |

| <i>(In thousands)</i>          | <b>UNITED KINGDOM</b> |        |                  |        |
|--------------------------------|-----------------------|--------|------------------|--------|
|                                | Three Months Ended    |        | Six Months Ended |        |
|                                | June 30               |        | June 30          |        |
|                                | 2011                  | 2010   | 2011             | 2010   |
| Interest cost                  | \$ 279                | \$ 250 | \$ 555           | \$ 512 |
| Expected return on plan assets | (264)                 | (210)  | (525)            | (428)  |
| Amortization of net loss       | 52                    | 67     | 103              | 136    |
| Net periodic benefit cost      | \$ 67                 | \$ 107 | \$ 133           | \$ 220 |

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

The Company expects to contribute approximately \$4,225,000 to its U.S. qualified defined benefit pension plans in 2011 and to pay \$268,000 in 2011 related to its unfunded non-qualified plans. As of June 30, 2011, \$1,444,000 had been contributed to the qualified plans and \$152,000 had been paid related to the non-qualified plans.

*U.K. Plan*

The Company's United Kingdom subsidiary expects to contribute approximately \$889,000 to its defined benefit pension plan in 2011. As of June 30, 2011, \$461,000 had been contributed to the plan.

**Defined Contribution Plans**

Defined contribution plan expenses for the Company's retirement savings plan were \$1,005,000 and \$1,955,000, respectively, for the three and six months ended June 30, 2011, compared to \$1,170,000 and \$2,294,000, respectively, for three and six months ended June 30, 2010.

Expenses related to the Company's profit sharing plan were \$1,510,000 and \$2,660,000, respectively, for the three and six months ended June 30, 2011, compared to \$1,350,000 and \$2,726,000, respectively, for the three and six months ended June 30, 2010.

**10. EARNINGS PER SHARE**

Below is the computation of basic and diluted earnings per share for the three and six months ended June 30, 2011 and 2010.

| <i>(In thousands, except per share amounts)</i>  | Three Months Ended |                 | Six Months Ended |                 |
|--|--------------------|-----------------|------------------|-----------------|
|  | June 30<br>2011    | June 30<br>2010 | June 30<br>2011  | June 30<br>2010 |
| <b><u>Computation of Basic Earnings per Share</u></b>  |                    |                 |                  |                 |
| Net income attributable to Stepan Company  | \$ 20,867          | \$ 17,046       | \$ 39,628        | \$ 37,706       |
| Deduct dividends on preferred stock  | 179                | 188             | 358              | 376             |
| Income applicable to common stock  | \$ 20,688          | \$ 16,858       | \$ 39,270        | \$ 37,330       |
| Weighted-average number of common shares outstanding   | 10,345             | 10,160          | 10,335           | 10,130          |
| Basic earnings per share   | \$ 2.00            | \$ 1.66         | \$ 3.80          | \$ 3.69         |
| <b><u>Computation of Diluted Earnings per Share</u></b>  |                    |                 |                  |                 |
| Net income attributable to Stepan Company  | \$ 20,867          | \$ 17,046       | \$ 39,628        | \$ 37,706       |
| Weighted-average number of common shares outstanding   | 10,345             | 10,160          | 10,335           | 10,130          |
| Add net shares issuable from assumed exercise of options (under treasury stock method) <sup>(1)</sup>                            | 237                | 273             | 244              | 267             |
| Add contingently issuable net shares related to performance stock awards and unvested stock awards (under treasury stock method) | 2                  | 63              | 2                | 32              |
| Add weighted-average shares issuable from assumed conversion of convertible preferred stock                                      | 594                | 622             | 594              | 623             |
| Shares applicable to diluted earnings  | 11,178             | 11,118          | 11,175           | 11,052          |
| Diluted earnings per share   | \$ 1.87            | \$ 1.53         | \$ 3.55          | \$ 3.41         |

<sup>(1)</sup> Options to purchase 63,167 and 61,516 shares of common stock were not included in the computations of diluted earnings per share for the three and six months ended June 30, 2011, respectively. The options' exercise prices were greater than the average market price for the common stock and their effect would have been antidilutive. There were no antidilutive stock options for the three and six months ended June 30, 2010.

11. 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, 2011 and 2010:

| <i>(In thousands)</i>   | Three Months Ended<br>June 30 |           | Six Months Ended<br>June 30 |           |
|---|-------------------------------|-----------|-----------------------------|-----------|
|   | 2011                          | 2010      | 2011                        | 2010      |
| Net income  | \$ 21,006                     | \$ 17,069 | \$ 39,822                   | \$ 37,750 |
| Other comprehensive income:                                   |                               |           |                             |           |
| Foreign currency translation gains (losses)                   | 3,964                         | (7,842)   | 10,081                      | (8,674)   |
| Pension liability adjustments, net of tax                     | 521                           | 377       | 1,044                       | 756       |
| Derivative instrument gain, net of tax                        | 315                           |           | 389                         |           |
| Comprehensive income  | 25,806                        | 9,604     | 51,336                      | 29,832    |
| Comprehensive income attributable to noncontrolling interests | (167)                         | (23)      | (236)                       | (44)      |
| Comprehensive income attributable to Stepan Company           | \$ 25,639                     | \$ 9,581  | \$ 51,100                   | \$ 29,788 |

12. SEGMENT REPORTING

The Company has three reportable segments: surfactants, polymers and specialty products. Segment operating results for the three and six months ended June 30, 2011 and 2010 are summarized below:

| <i>(In thousands)</i>                           | Surfactants | Polymers   | Specialty<br>Products | Segment<br>Totals |
|---|-------------|------------|-----------------------|-------------------|
| <u>For the three months ended June 30, 2011</u> |             |            |                       |                   |
| Net sales                                       | \$ 343,767  | \$ 120,854 | \$ 12,368             | \$ 476,989        |
| Operating income                                | 24,693      | 15,064     | 3,485                 | 43,242            |
| <u>For the three months ended June 30, 2010</u> |             |            |                       |                   |
| Net sales                                       | \$ 264,567  | \$ 90,893  | \$ 11,044             | \$ 366,504        |
| Operating income                                | 26,735      | 10,512     | 3,776                 | 41,023            |
| <u>For the six months ended June 30, 2011</u>   |             |            |                       |                   |
| Net sales                                       | \$ 668,652  | \$ 207,253 | \$ 23,682             | \$ 899,587        |
| Operating income                                | 52,857      | 21,429     | 6,749                 | 81,035            |
| <u>For the six months ended June 30, 2010</u>   |             |            |                       |                   |
| Net sales                                       | \$ 526,880  | \$ 154,003 | \$ 22,651             | \$ 703,534        |
| Operating income                                | 55,988      | 17,164     | 7,999                 | 81,151            |

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

| <i>(In thousands)</i>                         | Three Months Ended |           | Six Months Ended |           |
|---|--------------------|-----------|------------------|-----------|
|   | June 30            |           | June 30          |           |
|   | 2011               | 2010      | 2011             | 2010      |
| Operating income segment totals               | \$ 43,242          | \$ 41,023 | \$ 81,035        | \$ 81,151 |
| Unallocated corporate expenses <sup>(1)</sup> | (9,164)            | (11,251)  | (17,106)         | (17,724)  |
| Total operating income                        | 34,078             | 29,772    | 63,929           | 63,427    |
| Interest expense, net                         | (2,194)            | (1,510)   | (4,257)          | (2,766)   |
| Loss from equity in joint ventures            | (805)              | (764)     | (1,770)          | (1,335)   |
| Other, net                                    | 253                | (1,111)   | 565              | (1,333)   |
| Consolidated income before income taxes       | \$ 31,332          | \$ 26,387 | \$ 58,467        | \$ 57,993 |

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

13. DEBT

At June 30, 2011, and December 31, 2010, debt comprised the following:

| <i>(In thousands)</i>                     | Maturity Dates | June 30, 2011 | December 31, 2010 |
|---|----------------|---------------|-------------------|
| <b>Unsecured private placement notes</b>  |                |               |                   |
| 5.88%                                     | 2016-2022      | \$ 40,000     | \$ 40,000         |
| 5.69%                                     | 2012-2018      | 40,000        | 40,000            |
| 6.86%                                     | 2011-2015      | 21,428        | 21,428            |
| 6.59%                                     | 2011-2012      | 5,454         | 5,454             |
| Unsecured bank term loan                  | 2012-2013      | 25,500        | 27,000            |
| Build-to-suit obligation                  |                |               | 11,384            |
| Unsecured U.S. bank debt                  | 2013           | 6,900         |                   |
| <b>Debt of foreign subsidiaries</b>       |                |               |                   |
| Secured bank term loans, foreign currency | 2011-2015      | 7,946         | 8,156             |
| Secured bank term loan, U.S. dollars      | 2011-2014      | 7,000         | 7,000             |
| Other loans, foreign currency             | 2011-2015      | 22,694        | 18,142            |
| Seller notes, foreign currency            | 2011-2013      | 13,843        | 13,008            |
| Total debt                                |                | \$ 190,765    | \$ 191,572        |
| Less current maturities                   |                | 35,809        | 31,609            |
| Long-term debt                            |                | \$ 154,956    | \$ 159,963        |

As of June 30, 2011, there were \$6,900,000 of debt and \$2,612,000 of letters of credit outstanding under the \$60,000,000 U.S. revolving credit agreement. There was \$50,488,000 available under the agreement at June 30, 2011.



On January 19, 2010, the Company entered into a build-to-suit lease agreement for the construction of a warehouse at its Millsdale (Joliet), Illinois, manufacturing site. On March 18, 2011, the Company purchased this warehouse for \$12,206,000, which eliminated the build-to-suit obligation. The difference between the purchase price and the carrying value of the build-to-suit obligation at the time of purchase was recorded as an increase to property, plant and equipment.

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 \$167,063,000 and \$138,727,000 at June 30, 2011, and December 31, 2010, respectively.

14. OTHER, NET

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

| <i>(In thousands)</i>                              | Three Months Ended |            | Six Months Ended |            |
|--|--------------------|------------|------------------|------------|
|  | June 30            |            | June 30          |            |
|  | 2011               | 2010       | 2011             | 2010       |
| Foreign exchange gain (loss)                       | \$ 279             | \$ (425)   | \$ 105           | \$ (996)   |
| Investment related income                          | 9                  | 15         | 22               | 30         |
| Realized and unrealized gain (loss) on investments | (35)               | (701)      | 438              | (367)      |
| Other, net   | \$ 253             | \$ (1,111) | \$ 565           | \$ (1,333) |

15. RECENT ACCOUNTING PRONOUNCEMENTS

In December 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update No. 2010-29, Business Combinations (Topic 805): Disclosures of Supplementary Pro Forma Information for Business Combinations (ASU 2010-29), which specifies that pro forma disclosures for business combinations are to be reported as if the business combinations that occurred during the current year had occurred as of the beginning of the comparable prior annual reporting period. The pro forma disclosures must also include a description of material, nonrecurring pro forma adjustments. ASU 2010-29 is effective for business combinations with an acquisition date of January 1, 2011 or later. Adoption of the new requirement did not have an effect on the Company's financial position, results of operations or cash flows.

In May 2011, the FASB issued Accounting Standards Update No. 2011-04, Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. The amendments result in common fair value measurement and disclosure requirements in U.S. generally accepted accounting principles (GAAP) and International Financial Reporting Standards (IFRSs), and do not require additional fair value measurements and are not intended to establish valuation standards or affect valuation practices. The amendments in this update are effective during interim and annual periods beginning after December 15, 2011. Adoption of the new requirement is not expected to have an effect on the Company's financial position, results of operations or cash flow.

In June 2011, the FASB issued Accounting Standards Update No. 2011-05, *Comprehensive Income (Topic 220): Presentation of Comprehensive Income*. In this update, FASB eliminated the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity. The amendments require that all non-owner changes in equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The amendments in this update are effective for fiscal years, and interim periods within these years, beginning after December 15, 2011. Although adoption of the new requirement will have an effect on the Company's presentation of comprehensive income, it will not have an effect on the Company's financial position, results of operations or cash flow.

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

The following is management's discussion and analysis 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.

Except for the historical statements contained in this report, the matters discussed in the following discussion and analysis are forward-looking statements that are subject to certain risks, uncertainties and assumptions. Such forward-looking statements are intended to be identified in this document by the words, anticipate, believe, estimate, expect, intend, may, objective, outlook, plan, project, possible, potential, 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, 2010.

**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 74 percent of consolidated net sales for the first half of 2011, are principal ingredients in consumer and industrial cleaning products such as detergents for washing clothes, dishes, carpets, floors and walls, as well as shampoos, body washes, toothpastes and fabric softeners. Other applications include germicidal quaternary compounds, lubricating ingredients, emulsifiers (for spreading agricultural products), plastics and composites and biodiesel. Surfactants are manufactured at six North American sites (five in the U.S. and one in Canada), three European sites (United Kingdom, France and Germany), three Latin American sites (Mexico, Brazil and Colombia) and one Asian site (Philippines; the Company acquired controlling interest in Stepan Philippines Inc. (SPI) on July 19, 2010). Also in the third quarter of 2010, the Company purchased assets in Singapore and initiated the development of a methyl esters plant in that location. Completion of the Singapore plant is expected in the second quarter of 2012. 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. The joint venture is accounted for under the equity method, and its financial results are excluded from surfactant segment operating results.

**Polymers** Polymers, which accounted for 23 percent of consolidated net sales for the first half of 2011, include two primary product lines: polyols and phthalic anhydride. Polyols are used in the manufacture of rigid laminate insulation board for thermal insulation in the construction industry. Polyols are also a base raw material for flexible foams, coatings, adhesives, sealants and elastomers. 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, phthalic anhydride is used internally in the production of polyols. In the U.S., polymer product lines are manufactured at the Company's Millsdale, Illinois, site. In Europe, polyols are manufactured at the Company's subsidiaries in Germany and Poland. The Poland entity was acquired in the third quarter of 2010. Polyols are also produced at the Company's 80-percent owned joint venture in Nanjing, China.

**Specialty Products** Specialty products, which accounted for three percent of consolidated net sales for the first quarter of 2011, include flavors, emulsifiers and solubilizers used in the food and pharmaceutical industries. Specialty products are primarily manufactured at the Company's Maywood, New Jersey, site. On June 23, 2011, the Company purchased three product lines from Lipid Nutrition B.V., a part of Lodders Croklaan B.V. See the Acquisition section that follows for details of the transaction.

*Acquisition*

On June 23, 2011, the Company purchased the Clarinol®, Marinol®, and PinnoThin® product lines of Lipid Nutrition B.V., a part of Lodders Croklaan B.V. The acquired product lines will be integrated into the Company's specialty products segment and will be combined with existing Company food and health services products to provide the Company with a unique portfolio of nutritional fats for the food, supplement and nutrition industries. The purchase included inventory, intangible assets and goodwill. No manufacturing assets were included in the acquisition. The acquired products will be manufactured at Stepan's Maywood, New Jersey, plant as well as at existing outside contract manufacturers for sale on a global basis. The purchase price of the acquisition was cash of \$13.6 million, inclusive of \$5.0 million of inventory.

*Deferred Compensation Plans*

The accounting for the Company's deferred compensation plans can cause period-to-period fluctuations in Company expenses and profits. Compensation income results when the values of Company common stock and mutual funds held for the plans decline, and compensation expense results when the values of Company common stock and mutual funds held for the plans increase. 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) for the three and six months ended June 30, 2011 and 2010, and the income statement line items in which the effects of the activities were recorded are displayed in the following tables:

| <i>(In millions)</i>                                  | Income (Expense)     |                 |                       |
|---|----------------------|-----------------|-----------------------|
|   | For the Three Months |                 |                       |
|   | Ended June 30        |                 |                       |
|   | 2011                 | 2010            | Change                |
| Deferred Compensation (Administrative expense)        | \$ 0.3               | (\$ 2.7)        | \$ 3.0 <sup>(1)</sup> |
| Realized/Unrealized Gains on Investments (Other, net) | 0.0                  | (0.7)           | 0.7                   |
| <b>Pretax Income Effect</b>                           | <b>\$ 0.3</b>        | <b>(\$ 3.4)</b> | <b>\$ 3.7</b>         |

- (1) The value of Company common stock declined \$1.60 per share from \$72.50 per share at March 31, 2011, to \$70.90 per share at June 30, 2011. For the second quarter of 2010, the Company's common stock price increased \$12.54 per share from \$55.89 per share at March 31, 2010, to \$68.43 per share at June 30, 2010.

| <i>(In millions)</i>                                  | Income (Expense)   |                 |                       |
|---|--------------------|-----------------|-----------------------|
|   | For the Six Months |                 |                       |
|   | Ended June 30      |                 |                       |
|   | 2011               | 2010            | Change                |
| Deferred Compensation (Administrative expense)        | \$ 0.7             | (\$ 0.9)        | \$ 1.6 <sup>(1)</sup> |
| Realized/Unrealized Gains on Investments (Other, net) | 0.4                | (0.4)           | 0.8                   |
| <b>Pretax Income Effect</b>                           | <b>\$ 1.1</b>      | <b>(\$ 1.3)</b> | <b>\$ 2.4</b>         |

- (1) The value of Company common stock declined \$5.37 per share from \$76.27 per share at December 31, 2010, to \$70.90 per share at June 30, 2011. For the first six months of 2010, the Company's common stock price increased \$3.62 per share from \$64.81 per share at December 31, 2009, to \$68.43 per share at June 30, 2010.

*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). For the three and six month periods ended June 30, 2011, the U.S. dollar weakened against all the foreign currencies in the locations where the Company does business, when compared to the exchange rates for the respective three and six month periods ended June 30, 2010. Consequently, reported net sales, expense and income amounts for the three and six month periods ended June 30, 2011, were higher than they would have been had the foreign currency exchange rates remained constant with the rates for the same periods 2010. The following table presents the effect that foreign currency translation had on the quarter-over-quarter and year-over-year changes in consolidated net sales and various income line items for the three and six months ended June 30, 2011:

| <i>(In millions)</i> | Three Months Ended<br>June 30 |          |          | Increase<br>Due to<br>Foreign<br>Translation |
|----------------------|-------------------------------|----------|----------|--|
|                      | 2011                          | 2010     | Increase |  |
| Net Sales            | \$ 477.0                      | \$ 366.5 | \$ 110.5 | \$ 16.6                                      |
| Gross Profit         | 69.6                          | 63.5     | 6.1      | 1.5  |
| Operating Income     | 34.1                          | 29.8     | 4.3      | 0.6  |
| Pretax Income        | 31.3                          | 26.4     | 4.9      | 0.4  |

  

| <i>(In millions)</i> | Six Months Ended<br>June 30 |          |          | Increase<br>Due to<br>Foreign<br>Translation |
|----------------------|-----------------------------|----------|----------|--|
|                      | 2011                        | 2010     | Increase |  |
| Net Sales            | \$ 899.6                    | \$ 703.5 | \$ 196.1 | \$ 20.1                                      |
| Gross Profit         | 131.4                       | 127.0    | 4.4      | 1.9  |
| Operating Income     | 63.9                        | 63.4     | 0.5      | 0.9  |
| Pretax Income        | 58.5                        | 58.0     | 0.5      | 0.6  |

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RESULTS OF OPERATIONS

Three Months Ended June 30, 2011 and 2010

*Summary*

Net income attributable to the Company for the second quarter of 2011 increased 22 percent to \$20.9 million, or \$1.87 per diluted share, compared to \$17.0 million, or \$1.53 per diluted share, for the second quarter of 2010. 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 second quarter of 2011 follows the summary.

Consolidated net sales increased \$110.5 million, or 30 percent, year over year. Higher average selling prices, the effects of foreign currency translation and higher sales volume accounted for approximately \$ 93.0 million, \$16.6 million and \$0.9 million, respectively, of the increase. The rise in average selling prices was primarily attributable to price increases resulting from higher quarter-over-quarter raw material costs. The foreign currency translation effect reflected the weakening of the U.S. dollar against all foreign currencies in which the Company transacts business. Sales volume improved less than one percent, as increased volumes for polymers and specialty products were largely offset by a decline in surfactants sales volume.

Operating income for the second quarter of 2011 increased \$4.3 million, or 14 percent, over operating income reported in the second quarter of 2010. Gross profit improved \$6.1 million, or 10 percent, due largely to strong polymers growth. The effects of foreign currency translation contributed \$1.5 million to the year-over-year gross profit change.

Operating expenses increased \$1.8 million, or five percent, between comparative quarters due primarily to the following:

Marketing expenses increased \$2.8 million, or 30 percent, quarter over quarter. Expenses related to the Company's growth initiatives in Singapore and Poland and the consolidation of the Philippines entity accounted for \$1.0 million of the increase. Higher travel-related and salaried payroll expenses and the effects of foreign currency translation also contributed.

Administrative expenses declined \$1.6 million, or 11 percent, due to a \$3.0 million decrease in deferred compensation expense. The Company recorded \$0.3 million of deferred compensation income for the second quarter of 2011 compared to \$2.7 million of expense for the second quarter of 2010. The favorable swing in deferred compensation expense resulted primarily from changes in the price of Company common stock to which a large part of the deferred compensation obligation is tied. See the *Overview* and *Corporate Expenses* sections of this management discussion and analysis for further details. The effect of deferred compensation expense was partially offset by expenses for the Singapore, Philippines and Poland entities (\$0.7 million) and the impact of foreign currency translation.

Research, development and technical service expenses were up \$0.6 million, or six percent, quarter over quarter. Increased salaries and related fringe benefits accounted for most of the increase.

Interest expense, net for the second quarter of 2011 was up \$0.7 million, or 45 percent, over interest expense for the same quarter of 2010. Higher average debt levels led to the increase. The increase in the average debt levels were, in part, attributable to higher working capital requirements brought on by inflation in raw material costs. In addition, in June 2010, the Company secured \$40 million of additional long-term notes to take advantage of low interest rates and support global growth initiatives. The assumption of debt in the third quarter 2010 business acquisitions and a seller-financed equipment purchase arrangement transacted in the fourth quarter of 2010 contributed to the increase in the average debt level.

The loss from equity joint ventures, which included results for TIORCO for the second quarter of 2011 compared to results for TIORCO and SPI for the second quarter of 2010 (the Company acquired controlling interest of SPI in the third quarter of 2010), increased less than \$0.1 million between quarters. The equity loss in TIORCO declined less than \$0.1 million and the second quarter of last year included SPI equity income of \$0.1 million. The Company also sells surfactant products to TIORCO and its customers. The sales and resulting income from the sales are included in the Company's surfactants segment operating results.

Other, net was \$0.3 million of income for the second quarter of 2011 compared to \$1.1 million of expense for the second quarter of 2010, a favorable swing of \$1.4 million. The Company reported foreign exchange gains of \$0.3 million in the second quarter of 2011 compared to \$0.4 million of losses in the same quarter of 2010. Realized and unrealized losses related to the mutual fund investments held for the Company's deferred compensation plans was down \$0.7 million between quarters.

The effective tax rate was 33.0 percent for the second quarter ended June 30, 2011, compared to 35.3 percent for the second quarter ended June 30, 2010. The decrease was primarily attributable to the implementation of a holding company structure that will provide a recurring benefit in lowering the effective tax rate on foreign earnings. An increase in U.S. tax credits also contributed to the lower effective tax rate.

### Segment Results

| <i>(In thousands)</i>                    | Surfactants | Polymers   | Specialty Products | Segment Results | Corporate | Total      |
|--|-------------|------------|--------------------|-----------------|-----------|------------|
| For the three months ended June 30, 2011 |             |            |                    |                 |           |            |
| Net sales                                | \$ 343,767  | \$ 120,854 | \$ 12,368          | \$ 476,989      |           | \$ 476,989 |
| Operating income                         | 24,693      | 15,064     | 3,485              | 43,242          | (9,164)   | 34,078     |
| For the three months ended June 30, 2010 |             |            |                    |                 |           |            |
| Net sales                                | \$ 264,567  | \$ 90,893  | \$ 11,044          | \$ 366,504      |           | \$ 366,504 |
| Operating income                         | 26,735      | 10,512     | 3,776              | 41,023          | (11,251)  | 29,772     |



*Surfactants*

Surfactants net sales for the second quarter of 2011 increased \$79.2 million, or 30 percent, over net sales for the second quarter of 2010. Higher average selling prices and the effects of foreign currency translation accounted for approximately \$69.8 million and \$12.3 million, respectively, of the net sales growth. A one percent decline in sales volume reduced the net sales increase by \$2.9 million. A quarter-over-quarter comparison of net sales by region follows:

| <i>(In thousands)</i>            | For the Three Months Ended |                   | Increase         | Percent Change |
|----------------------------------|----------------------------|-------------------|------------------|----------------|
|                                  | June 30, 2011              | June 30, 2010     |                  |                |
| North America                    | \$ 216,648                 | \$ 179,221        | \$ 37,427        | +21            |
| Europe                           | 79,706                     | 58,478            | 21,228           | +36            |
| Latin America                    | 34,721                     | 26,868            | 7,853            | +29            |
| Asia                             | 12,692                     |                   | 12,692           | NM             |
| <b>Total Surfactants Segment</b> | <b>\$ 343,767</b>          | <b>\$ 264,567</b> | <b>\$ 79,200</b> | <b>+30</b>     |

Net sales for North American operations increased 21 percent due to a 30 percent increase in average selling prices and the effects of foreign currency translation, which accounted for \$50.0 million and \$0.9 million, respectively, of the net sales change. An eight percent decline in sales volume reduced the quarter-over-quarter increase by \$13.5 million. Average selling prices increased primarily as a result of higher costs for all major raw materials. The foreign currency translation effect resulted from the strengthening of the Canadian dollar against the U.S. dollar. Decreased sales volumes of laundry and cleaning products, due to nonrecurring business in the year ago quarter and lower demand, accounted for the sales volume decline.

Net sales for European operations increased 36 percent due to a 43 percent increase in average selling prices and the favorable effects of foreign currency translation, which accounted for \$21.5 million and \$8.3 million, respectively of the net sales increase. A 15 percent decline in sales volume reduced the net sales change by \$8.6 million. Selling price increases made between the comparative periods, reflecting rapidly escalating raw material costs, accounted for the significant rise in average selling prices. The foreign currency translation impact resulted from the strengthening of the European euro and British pound sterling against the U.S. dollar.

Net sales for Latin American operations were up 29 percent due to a 22 percent increase in sales volume and the favorable effects of foreign currency translation, which accounted for \$6.0 million and \$3.0 million, respectively, of the net sales improvement. A four percent decline in average selling prices, attributable largely to mix of sales, reduced the quarter-over-quarter net sales change by \$1.1 million. Although all three Latin American locations contributed to the net sales growth, additional business for the Company's Brazil subsidiary accounted for approximately 84 percent of the quarter-over-quarter increase in sales volume. The favorable currency translation impact resulted from the strengthening of the currencies for all three Latin American locations against the U.S. dollar.

The \$12.7 million of net sales for Asia operations reflected sales by the Company's Philippines subsidiary, which is now consolidated.

Surfactants operating income for the second quarter of 2011 was down \$2.0 million, or eight percent, from operating income for the second quarter of 2010. Gross profit increased \$1.5 million, or three percent, as improved margins in North America and Europe, coupled with the consolidation of the Philippines subsidiary, more than offset the impacts of lower sales volume and costs related to the start up of the capacity expansion in Brazil. The effects of foreign currency translation contributed \$0.9 million to the quarter-over-quarter gross profit increase. Operating expenses increased \$3.6 million, or 20 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 |               | Increase<br>(Decrease) | Percent<br>Change |
|-------------------------------|----------------------------|---------------|------------------------|-------------------|
|                               | June 30, 2011              | June 30, 2010 |                        |                   |
| <b>Gross Profit</b>           |                            |               |                        |                   |
| North America                 | \$ 36,862                  | \$ 34,365     | \$ 2,497               | +7                |
| Europe                        | 6,148                      | 5,535         | 613                    | +11               |
| Latin America                 | 1,931                      | 4,425         | (2,494)                | -56               |
| Asia                          | 928                        |               | 928                    | NM                |
| <br>Total Surfactants Segment | <br>\$ 45,869              | <br>\$ 44,325 | <br>\$ 1,544           | <br>+3            |
| <b>Operating Expenses</b>     | <b>21,176</b>              | <b>17,590</b> | <b>3,586</b>           | <b>+20</b>        |
| <br>Operating Income          | <br>\$ 24,693              | <br>\$ 26,735 | <br>\$ (2,042)         | <br>-8            |

North American gross profit was up seven percent between quarters despite lower sales volume. The previously noted increase in average selling prices, coupled with a more favorable mix of sales, helped to offset the impact of the decrease in sales volume. The Company announced selling price increases effective July 1, 2011.

Gross profit for European operations increased 11 percent due largely to the favorable effect of foreign currency translation (\$0.6 million). The previously mentioned selling price increases offset the effects of higher raw material costs and the decline in sales volume.

Despite the 22 percent increase in sales volume, gross profit for Latin American operations was down 56 percent quarter over quarter. The drop in profit was primarily attributable to one-time costs related to a delay in the start up of the recent neutralizer capacity expansion project in Brazil. In addition to the unplanned costs for Brazil, the decline in gross profit also reflected selling price increases that lagged raw material cost increases, particularly for the Mexico subsidiary.

The \$0.9 million of gross profit for Asia operations reflected profits earned by the Company's Philippines subsidiary.

Operating expenses for the surfactants segment were up \$3.6 million, or 20 percent, quarter over quarter. Increased expenses for North American operations (\$1.9 million), additional expenses for the Singapore and Philippines locations, which were first consolidated in the third quarter of 2010 (\$0.7 million), and the effects of foreign currency translation (\$0.7 million) accounted for most of the overall operating expense increase. Increased marketing (\$1.8 million) expenses led to the higher North American operations expense, due in part to expenses to support the growing operations in Asia.

*Polymers*

Polymers net sales for the second quarter of 2011 increased \$30.0 million, or 33 percent, over net sales for the last year's second quarter. Higher average selling prices, a six percent improvement in sales volume and the favorable effects of foreign currency translation accounted for \$20.6 million, \$5.1 million and \$4.3 million, respectively, of the increase. A quarter-over-quarter comparison of net sales by region is displayed below:

| <i>(In thousands)</i>  | For the Three Months Ended |               |           | Percent<br>Change |
|------------------------|----------------------------|---------------|-----------|-------------------|
|                        | June 30, 2011              | June 30, 2010 | Increase  |                   |
| North America          | \$ 75,392                  | \$ 61,611     | \$ 13,781 | +22               |
| Europe                 | 36,847                     | 23,803        | 13,044    | +55               |
| Asia and Other         | 8,615                      | 5,479         | 3,136     | +57               |
| Total Polymers Segment | \$ 120,854                 | \$ 90,893     | \$ 29,961 | +33               |

Net sales for North American operations increased 22 percent due primarily to a 22 percent increase in average selling prices, which accounted for \$13.4 million of the increase in net sales. Sales volume was up one percent and added \$0.4 million to the quarter-over-quarter net sales change. The higher average selling prices reflected rising raw material costs for all polymer product lines. Polyols sales volume grew nine percent on improved rigid insulation board demand from existing customers. External sales volume for phthalic anhydride declined 10 percent due to a decrease in demand for polyester resins (which are used to manufacture materials for the automobile, construction, marine and recreational vehicle industries). Internal consumption of phthalic anhydride increased on higher sales volume of polyols.

Net sales for European operations grew 55 percent due to a 23 percent increase in average selling prices, the favorable effects of foreign currency translation and a 12 percent increase in sales volume, which accounted for \$6.2 million, \$4.0 million and \$2.8 million, respectively, of the net sales improvement. Increased raw material costs led to the higher average selling prices. The Company's Poland subsidiary, which was acquired in the third quarter of 2010, accounted for 58 percent of the quarter-over-quarter sales volume growth. The remainder of the sales volume increase reflected higher volumes to a number of existing customers. The foreign currency translation effect reflected a strengthening of the European euro against the U.S. dollar between the comparative periods.

Asia and Other operations' net sales were up 57 percent quarter over quarter due to a 36 percent increase in sales volume and a 12 percent increase in average selling prices. New business secured by the Company's China subsidiary led to the quarter-over-quarter growth in sales volume. Higher raw material costs drove the selling price increase.

Polymer operating income for the second quarter of 2011 increased \$4.5 million, or 43 percent, over operating income for the same quarter of 2010. Gross profit grew \$5.5 million, or 37 percent, as all three regions reported improved results. Operating expenses increased \$1.0 million, or 21 percent, between quarters. Below are quarter-over-quarter comparisons of gross profit by region and total segment operating expenses and operating income:

| (In thousands)                | For the Three Months Ended |                  |                 | Percent Change |
|-------------------------------|----------------------------|------------------|-----------------|----------------|
|                               | June 30, 2011              | June 30, 2010    | Increase        |                |
| <b>Gross Profit</b>           |                            |                  |                 |                |
| North America                 | \$ 15,193                  | \$ 11,833        | \$ 3,360        | +28            |
| Europe                        | 4,668                      | 2,789            | 1,879           | +67            |
| Asia and Other                | 698                        | 418              | 280             | +67            |
| <b>Total Polymers Segment</b> | <b>\$ 20,559</b>           | <b>\$ 15,040</b> | <b>\$ 5,519</b> | <b>+37</b>     |
| Operating Expenses            | 5,495                      | 4,528            | 967             | +21            |
| <b>Operating Income</b>       | <b>\$ 15,064</b>           | <b>\$ 10,512</b> | <b>\$ 4,552</b> | <b>+43</b>     |

Gross profit for North American operations increased 28 percent due to improved average unit margins and a nine percent increase in polyol sales volume. Despite a decline in sales volume, phthalic anhydride gross profit also improved as a result of better raw material inventory positions.

Gross profit for European operations was up 67 percent quarter over quarter due to the above-noted selling price increases, sales volume growth and \$0.6 million in favorable foreign currency translation impact. Margins were lower in the year ago quarter as selling price increases did not keep pace with raw material cost increases.

The increase in gross profit for Asia and Other operations reflected the 36 percent increase in sales volume.

The \$1.0 million increase in operating expenses was principally attributable to higher expenses for European operations (\$0.6 million), North American operations (\$0.2 million) and the unfavorable effects of foreign currency translation (\$0.2 million). Approximately \$0.5 million of the increase for European operations was attributable to the Poland subsidiary that was not acquired until the third quarter of 2010.

#### *Specialty Products*

Net sales for the second quarter of 2011 were \$1.3 million, or 12 percent, higher than net sales for the second quarter of 2010. Higher sales volume for food ingredient and flavoring products accounted for most of the increase in net sales. Operating income was down \$0.3 million, or eight percent, quarter over quarter due to higher raw material costs, particularly for food ingredient products for which competitive pressures have made it difficult to raise selling prices.

*Corporate Expenses*

Corporate expenses, which comprise operating expenses that are not allocated to the reportable segments, declined \$2.1 million (19 percent) to \$9.2 million for the second quarter of 2011 from \$11.3 million for the second quarter of 2010. Deferred compensation expense accounted for the decline, as the Company recorded \$0.3 million of deferred compensation income for the second quarter of 2011 compared to \$2.7 million of expense for the second quarter of 2010. The value of Company common stock, to which a large portion of the deferred compensation obligation is tied, declined \$1.60 per share from \$72.50 per share at March 31, 2011, to \$70.90 per share at June 30, 2011. For last year's second quarter, the Company's common stock price increased \$12.54 per share from \$55.89 per share at March 31, 2010, to \$68.43 per share at June 30, 2010. The accounting treatment for the Company's deferred compensation plans results in income when the value of Company common stock held in the plans falls and expense when the value of Company common stock increases. Partially offsetting the effect of the change in deferred compensation was \$0.6 million of higher quarter-over-quarter expense related to derivative income reported in 2010 arising from recording certain electric contracts at fair value. The Company held no such contracts during 2011.

Six Months Ended June 30, 2011 and 2010

**Summary**

Net income attributable to the Company for the first half of 2011 increased five percent to \$39.6 million, or \$3.55 per diluted share, compared to \$37.7 million, or \$3.41 per diluted share, for the first half of 2010. Below is a summary discussion of the major factors leading to the year-over-year changes in net sales, profits and expenses. A detailed discussion of segment operating performance for the first half of 2011 follows the summary.

Consolidated net sales increased \$196.1 million, or 28 percent, between years. Higher average selling prices, the effects of foreign currency translation and higher sales volume accounted for approximately \$162.8 million, \$20.1 million and \$13.2 million, respectively, of the increase. The rise in average selling prices was primarily attributable to price increases resulting from higher year-over-year raw material costs. The foreign currency translation effect reflected the weakening of the U.S. dollar against all foreign currencies in which the Company transacts business. Consolidated sales volume improved two percent.

Operating income for the first half of 2011 increased \$0.5 million, or one percent, over operating income reported for the first half of 2010. Gross profit improved \$4.3 million, or three percent, primarily on improved results for the polymers segment. Surfactants segment was also up year over year, but increased raw material costs led to a decline in gross profit for the specialty products segment. The effects of foreign currency translation added \$1.9 million to the year-over-year increase in gross profit.

Operating expenses increased \$3.8 million, or six percent, between years due primarily to the following:

Marketing expenses increased \$2.7 million, or 13 percent, year over year. Expenses related to the Company's growth initiatives in Singapore and Poland and the consolidation of the Philippines entity accounted for \$1.6 million of the increase. Increased travel-related expenses and the effects of foreign currency translation also contributed.

Administrative expenses increased \$0.2 million, or one percent, due to \$0.9 million of added expenses related to the acquired entities that were not consolidated until the third quarter of 2010, as well as to higher year-over-year consulting (\$0.3 million) and salaries (\$0.2 million) expenses. The effects of foreign currency translation also contributed to the increase. The effects of the foregoing were largely offset by a \$1.6 million decline in deferred compensation expense. See the Overview and Corporate Expenses sections of this management discussion and analysis for further details.

Research, development and technical service expenses were up \$1.0 million, or five percent. Higher U.S. salaries expense accounted for \$0.5 million of the increase.

Interest expense, net for the first half of 2011 was up \$1.5 million, or 54 percent, between years. Higher average debt levels caused the increase. Higher average debt levels led to the increase. The increase in the average debt levels were, in part, attributable to higher working capital requirements brought on by inflation in raw material costs. In addition, in June 2010, the Company secured \$40 million of additional long-term notes to take advantage of low interest rates and support global growth initiatives. The assumption of debt in the third quarter 2010 business acquisitions and a seller-financed equipment purchase arrangement transacted in the fourth quarter of 2010 contributed to the increase in the average debt level.

The loss from equity joint ventures, which included results for TIORCO for the first half of 2011 and the results for TIORCO and SPI for the first half of 2010 (the Company acquired controlling interest of SPI in the third quarter of 2010), increased \$0.4 million year over year. The equity loss in TIORCO increased less than \$0.1 million between years and the first half of 2010 included SPI equity income of \$0.4 million.

Other, net was \$0.6 million of income for the first half of 2011 compared to \$1.3 million of expense for the same period of 2010, a favorable swing of \$1.9 million. The Company reported foreign exchange gains of \$0.1 million in the first half of 2011 compared to \$1.0 million of losses in the first half of 2010. In addition, for the first half of 2011, the Company reported \$0.4 million of realized and unrealized gains on the mutual funds held to fund the Company's deferred compensation plans compared to \$0.4 million of loss for the same period of last year.

The effective tax rate was 31.9 percent for the six months ended June 30, 2011 compared to 34.9 percent for the six months ended June 30, 2010. The decrease was primarily attributable to the implementation of a holding company structure that will provide a recurring benefit in lowering the effective tax rate on foreign earnings. An increase in U.S. tax credits also contributed to the lower effective tax rate.

**Segment Results**

| <i>(In thousands)</i>                  | Surfactants | Polymers   | Specialty Products | Segment Results | Corporate | Total      |
|--|-------------|------------|--------------------|-----------------|-----------|------------|
| For the six months ended June 30, 2011 |             |            |                    |                 |           |            |
| Net sales                              | \$ 668,652  | \$ 207,253 | \$ 23,682          | \$ 899,587      |           | \$ 899,587 |
| Operating income                       | 52,857      | 21,429     | 6,749              | 81,035          | (17,106)  | 63,929     |
| For the six months ended June 30, 2010 |             |            |                    |                 |           |            |
| Net sales                              | \$ 526,880  | \$ 154,003 | \$ 22,651          | \$ 703,534      |           | \$ 703,534 |
| Operating income                       | 55,988      | 17,164     | 7,999              | 81,151          | (17,724)  | 63,427     |

**Surfactants**

Surfactants net sales for the first half of 2011 increased \$141.8 million, or 27 percent, over net sales for the first half of 2010. Higher average selling prices and the effects of foreign currency translation accounted for approximately \$126.4 million and \$15.9 million, respectively, of the net sales change. Sales volume for the first half of 2011 approximated sales volume for the first half of last year. A year-over-year comparison of net sales by region follows:

| <i>(In thousands)</i>            | For the Six Months Ended |                   | Increase          | Percent Change |
|----------------------------------|--------------------------|-------------------|-------------------|----------------|
|                                  | June 30, 2011            | June 30, 2010     |                   |                |
| North America                    | \$ 422,798               | \$ 357,841        | \$ 64,957         | +18            |
| Europe                           | 156,899                  | 118,058           | 38,841            | +33            |
| Latin America                    | 66,918                   | 50,981            | 15,937            | +31            |
| Asia                             | 22,037                   |                   | 22,037            | NM             |
| <b>Total Surfactants Segment</b> | <b>\$ 668,652</b>        | <b>\$ 526,880</b> | <b>\$ 141,772</b> | <b>+27</b>     |

Net sales for North American operations increased 18 percent due to a 26 percent increase in average selling prices and the effects of foreign currency translation, which accounted for \$86.3 million and \$2.0 million, respectively, of the net sales change. A seven percent decline in sales volume reduced the year-over-year change by \$23.3 million. Higher costs for all major raw materials drove the increase in average selling prices. The foreign currency translation effect resulted from the strengthening of the Canadian dollar against the U.S. dollar. Sales volume declined largely due to an 11 percent decrease in laundry and cleaning products. The decline in laundry sales volume was primarily attributable to nonrecurring business in the prior year and weaker demand.

Net sales for European operations increased 33 percent due to a 36 percent increase in average selling prices and the favorable effects of foreign currency translation, which accounted for \$39.1 million and \$8.9 million, respectively of the net sales increase. Sales volume declined eight percent between years. Selling price increases made between the comparative periods, reflecting higher raw material costs, led to the increase in average selling prices. Net sales for Latin American operations were up 31 percent as a result of a 17 percent increase in sales

volume, the favorable effects of foreign currency translation and a three percent increase in average selling prices, which accounted for \$8.9 million, \$5.0 million and \$2.0 million, respectively, of the year-over-year net sales increase. Additional business for the Company's Brazil subsidiary accounted for approximately 79 percent of the sales volume growth. Sales volumes were also up for the Mexico and Colombia subsidiaries. The favorable currency translation impact resulted from the strengthening of the currencies for all three Latin American locations against the U.S. dollar. The increase in average selling prices was attributable to increased raw material costs.

The \$22.0 million of net sales for Asia operations reflected sales by the Company's Philippines subsidiary, which is now consolidated.

Surfactants operating income for the first half of 2011 was \$3.1 million lower than operating income for the same period of a year ago. Gross profit increased \$0.6 million due principally to the effects of improved margins in North America and the inclusion of the Philippines income in segment results. Lower Latin America gross profit, due largely to costs related to the start up of the capacity expansion in Brazil, negatively impacted surfactants' gross profit. Operating expenses increased \$3.7 million, or 10 percent. Year-over-year comparisons of gross profit by region and total segment operating expenses and operating income follow:

| <i>(In thousands)</i>            | For the Six Months Ended |                  | Increase<br>(Decrease) | Percent<br>Change |
|----------------------------------|--------------------------|------------------|------------------------|-------------------|
|                                  | June 30, 2011            | June 30, 2010    |                        |                   |
| <b>Gross Profit</b>              |                          |                  |                        |                   |
| North America                    | \$ 74,408                | \$ 71,603        | \$ 2,805               | +4                |
| Europe                           | 11,849                   | 12,602           | (753)                  | -6                |
| Latin America                    | 5,096                    | 8,461            | (3,365)                | -40               |
| Asia                             | 1,899                    |                  | 1,899                  | NM                |
| <b>Total Surfactants Segment</b> | <b>\$ 93,252</b>         | <b>\$ 92,666</b> | <b>\$ 586</b>          | <b>+1</b>         |
| <b>Operating Expenses</b>        | <b>40,395</b>            | <b>36,678</b>    | <b>3,717</b>           | <b>+10</b>        |
| <b>Operating Income</b>          | <b>\$ 52,857</b>         | <b>\$ 55,988</b> | <b>\$ (3,131)</b>      | <b>-6</b>         |

North American gross profit improved four percent between years on sales volume that declined seven percent. The previously noted increase in average selling prices, coupled with a more favorable mix of sales, helped to offset the impact of the decrease in sales volume. As noted in the quarter-over-quarter discussion, the Company announced selling price increases effective July 1, 2011.

Gross profit for European operations declined six percent due to the eight percent decline in sales volume and the negative effects of higher raw material costs. The previously mentioned selling price increases did not keep pace with the rapid rise in raw material costs. The favorable effects of foreign currency translation lessened the year-over-year decline in gross profit by \$0.6 million.

Gross profit for Latin American operations was down 40 percent despite the 17 percent increase in sales volume. One-time costs related to a delay in the start up of the recent neutralizer capacity expansion project in Brazil and increased manufacturing costs attributable to the new neutralizing equipment more than offset the effect of the higher sales volume. In addition to the costs for Brazil, the decline in gross profit also reflected selling price increases that lagged raw material cost increases, particularly for the Mexico subsidiary.



The \$1.9 million of gross profit for Asia operations reflected profits earned by the Company's Philippines subsidiary.

Operating expenses for the surfactants segment increased \$3.7 million, or 10 percent, year over year. Higher expenses for North American operations (\$1.6 million), additional expenses for the Singapore and Philippines locations, which were first consolidated in the third quarter of 2010 (\$1.1 million), and the effects of foreign currency translation (\$0.9 million) accounted for most of the operating expense increase. Increased support expenses for the expanding Asia operations accounted for most of the increase in North American operating expenses.

#### Polymers

Polymers net sales for the first half of 2011 increased \$53.3 million, or 35 percent, from net sales for the same period of 2010. Higher average selling prices, an 11 percent improvement in sales volume and the effects of foreign currency translation accounted for \$31.7 million, \$17.4 million and \$4.2 million, respectively, of the increase. A year-over-year comparison of net sales by region is displayed below:

| (In thousands)         | For the Six Months Ended |               |           | Percent Change |
|------------------------|--------------------------|---------------|-----------|----------------|
|                        | June 30, 2011            | June 30, 2010 | Increase  |                |
| North America          | \$ 129,581               | \$ 103,584    | \$ 25,997 | +25            |
| Europe                 | 65,427                   | 42,243        | 23,184    | +55            |
| Asia and Other         | 12,245                   | 8,176         | 4,069     | +50            |
| Total Polymers Segment | \$ 207,253               | \$ 154,003    | \$ 53,250 | +35            |

Net sales for North American operations increased 25 percent due to an 18 percent increase in average selling prices and a six percent increase in sales volume. The increases in average selling prices and sales volume accounted for \$19.7 million and \$6.3 million, respectively, of the increase in net sales. The higher average selling prices reflected higher raw material costs for all polymer product lines. Sales volume for polyols increased 14 percent, while sales volume for phthalic anhydride declined three percent. The sales volume improvement for polyols resulted primarily from increased demand from existing customers.

Net sales for European operations grew 55 percent due to a 20 percent increase in average selling prices, a 21 percent increase in sales volume and the favorable effects of foreign currency translation, which accounted for \$10.5 million, \$8.9 million and \$3.8 million, respectively, of the net sales improvement. Increased raw material costs led to the higher average selling prices. The higher sales volume reflected stronger demand from most major polyol customers. In addition, the Company's Poland subsidiary, which was acquired in the third quarter of 2010, accounted for 25 percent of the quarter-over-quarter sales volume growth.

Net sales for Asia and Other operations increased 50 percent year over year due to a 28 percent increase in sales volume, a 13 percent increase in average selling prices and the favorable effects of foreign currency translation. New business for the China subsidiary led to the improvement in sales volume. Higher raw material costs led to the increase in average selling prices.

Polymer operating income for the first half of 2011 increased \$4.3 million, or 25 percent, from operating income for the first half of 2010. Gross profit improved \$5.5 million, as all three regions posted growth. Operating expenses increased \$1.2 million, or 14 percent, between years. Below are year-over-year comparisons of gross profit by region and total segment operating expenses and operating income:

| <i>(In thousands)</i>         | For the Six Months Ended |                  |                 | Percent Change |
|-------------------------------|--------------------------|------------------|-----------------|----------------|
|                               | June 30, 2011            | June 30, 2010    | Increase        |                |
| <b>Gross Profit</b>           |                          |                  |                 |                |
| North America                 | \$ 23,753                | \$ 19,275        | \$ 4,478        | +23            |
| Europe                        | 7,034                    | 6,208            | 826             | +13            |
| Asia and Other                | 881                      | 698              | 183             | +26            |
| <b>Total Polymers Segment</b> | <b>\$ 31,668</b>         | <b>\$ 26,181</b> | <b>\$ 5,487</b> | <b>+21</b>     |
| Operating Expenses            | 10,239                   | 9,017            | 1,222           | +14            |
| <b>Operating Income</b>       | <b>\$ 21,429</b>         | <b>\$ 17,164</b> | <b>\$ 4,265</b> | <b>+25</b>     |

Gross profit for North American operations was up 23 percent due to improved unit margins and the six percent increase in sales volume noted earlier. The previously mentioned selling price increases coupled with better raw material inventory positions pushed the unit margins higher. A different mix of sales, precipitated by a greater proportion of polyol-to-phthalic anhydride sales, also contributed to the increased margin.

Gross profit for European operations increased 13 percent due to the 21 percent sales volume growth and \$0.5 million in favorable foreign currency translation impact. The effects of higher year-over-year raw material costs coupled with the outsourcing of polyols from the segment's North American operations due to capacity constraints partially offset the favorable impact of the sales volume growth.

Gross profit for Asia and Other operations increased 26 percent due to the 28 percent improvement in sales volume.

Operating expenses increased \$1.2 million year-over-year due largely to higher expenses for European operations (\$0.9 million). Expenses for the Poland subsidiary, acquired in the third quarter of last year, contributed \$0.5 million of the expense. Higher marketing expenses accounted for the remainder of the increase in operating expenses for European operations.

#### *Specialty Products*

Net sales for the first half of 2011 were \$1.0 million, or five percent, higher than net sales for the first half of 2010. Higher sales volume for food ingredient and flavoring products accounted for most of the increase in net sales. Operating income was down \$1.3 million, or 16 percent, between years due primarily to higher food ingredient raw material costs, for which competitive pressures have made it difficult to raise selling prices.

*Corporate Expenses*

Corporate expenses declined \$0.6 million (three percent) to \$17.1 million for the first half of 2011 from \$17.7 million for the first half of 2010. The following table depicts the major items that accounted for the year-over-year decline in corporate expenses:

| <i>(Dollars in millions)</i>  | Increase /<br>(Decrease) |
|-------------------------------|--------------------------|
| Deferred Compensation         | (\$ 1.6) <sup>(a)</sup>  |
| Derivative Electric Contracts | 0.4 <sup>(b)</sup>       |
| Consulting                    | 0.3                      |
| Salaries                      | 0.2                      |
| Legal and Environmental       | 0.2                      |
| Other                         | (0.1)                    |
| <b>Total</b>                  | <b>(\$ 0.6)</b>          |

- (a) The Company recorded \$0.7 million of deferred compensation income for the first half of 2011 compared to \$0.9 million of expense for the same period of 2010. The value of Company common stock, to which a large portion of the deferred compensation obligation is tied, declined \$5.37 per share from \$76.27 per share at December 31, 2010, to \$70.90 per share at June 30, 2011. For last year's first half, the Company's common stock price increased \$3.62 per share from \$64.81 per share at December 31, 2009, to \$68.43 per share at June 30, 2010. Partially offsetting the effects of the changes in Company common stock value were increases in the 2011 value of the mutual funds held for the plan versus decreases in 2010. The accounting treatment for the Company's deferred compensation plans results in income when the values of Company common stock and mutual funds held in the plans declines and expense when the values of Company common stock and mutual funds increases.
- (b) Reflects derivative income reported in 2010 arising from recording certain electric contracts at fair value. The Company held no such contracts during 2011.

**LIQUIDITY AND CAPITAL RESOURCES**

For the first six months of 2011, the Company used \$85.6 million of available cash plus \$7.4 million of net borrowings to fund a net operating cash use of \$21.3 million, net investing cash outflows of \$54.5 million and non-debt financing cash outflows of \$18.1 million, with exchange rates increasing cash by \$0.9 million. For the first half of 2011, net income was up by \$2.1 million and working capital consumed \$38.8 million more than for the same period in 2010. Investing cash outflows increased by \$25.6 million year over year. Cash flows from financing activities were a \$10.7 million use of cash for the first half of 2011 compared to a \$36.0 million source of cash for the first half of 2010.

For the first half of 2011, changes in accounts receivable comprised a use of \$83.9 million compared to a use of \$61.7 million for comparable period in 2010. Inventories were a use of \$55.1 million in 2011 versus a use of \$13.7 million in 2010. Accounts payable and accrued liabilities were a source of \$55.2 million during 2011 compared to a source of \$27.8 million in 2010.

During 2011, the rising cost of raw materials has been a key driver to higher working capital and the Company's overall cash flow. 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. Higher raw material costs translate directly to higher inventory carrying costs and indirectly to customer selling prices and accounts receivable.

The year-to-date accounts receivable increase was the result of higher current quarter-end sales, specifically June 2011 over December 2010, driven mainly by higher sales volume and, to a lesser extent, higher selling prices. Accounts receivable turnover did not change significantly between December 31, 2010 and June 30, 2011. For inventories, slightly less than 50 percent of the year-to-date inventory increase resulted from higher raw material costs with the rest attributable to planned increases in quantity 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 2011.

Investing cash outflows for the first half of 2011 totaled \$54.5 million compared to \$28.9 million for the comparable period in 2010. Capital expenditures for the first six months of 2011 totaled \$40.4 million, including higher spending for capacity expansion, compared to \$28.0 million for the same period in 2010. Current year investing outflows also included \$13.6 million, including \$5.0 million of product inventory, for the purchase of certain product lines of Lipid Nutrition B.V., a part of Loders Croklaan B.V. During 2011 the Company also liquidated \$1.6 million of investments for benefit plan participant payouts versus \$0.7 million in 2010.

For full-year 2011, the Company estimates that capital spending will range from \$85 million to \$90 million, net of an expected insurance recovery of \$3.9 million and including a capacity expansion in Singapore. The estimated range of capital expenditures excludes \$12.2 million for the purchase of the Millsdale (Joliet), Illinois, warehouse, which was reflected in financing activities during the first quarter of 2011. Prior to the cash purchase, the warehouse was recorded as an asset on the Company's balance sheet along with a build-to-suit lease obligation.

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. During the first six months of 2011, the Company purchased 15,562 common shares in the open market at a total cost of \$1.0 million. At June 30, 2011, there were 235,153 shares remaining under the current share repurchase authorization.

At June 30, 2011, the Company's cash and cash equivalents totaled \$25.6 million, including \$0.2 million in two 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 \$10.6 million and cash of the Company's non-U.S. subsidiaries held outside the U.S. totaled \$14.8 million as of June 30, 2011.

Consolidated debt decreased by \$0.8 million for the first half of 2011, from \$191.6 million to \$190.8 million, reflecting a decrease of \$6.0 million in U.S. debt and an increase of \$5.2 million in foreign debt. The increase in foreign debt was driven primarily by capital spending in Europe. The decrease in U.S. debt reflected the liquidation of the previously noted

build-to-suit lease obligation and an increase in revolving bank debt. Net debt (which is defined as total debt minus cash) increased by \$84.8 million for the six months of 2011, from \$80.4 million to \$165.2 million. At June 30, 2011, the ratio of total debt to total debt plus shareholders equity was 32.2 percent, versus 35.2 percent at December 31, 2010. The ratio of net debt to net debt plus shareholders equity was 29.2 percent as of June 30, 2011, compared to 18.5 percent at December 31, 2010.

As of June 30, 2011, the Company's debt included \$106.9 million of unsecured private placement loans with maturities extending from 2011 through 2022. 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's debt also included a \$25.5 million term loan with its U.S. banks, which has maturities in 2012 and 2013.

The Company maintains a committed \$60.0 million revolving credit agreement with three U.S. banks. This unsecured facility is the Company's primary source of short-term borrowings and is committed through August 27, 2013 with terms and conditions that are substantially equivalent to those of the Company's other U.S. loan agreements. As of June 30, 2011, the Company had borrowings of \$6.9 million and outstanding letters of credit of \$2.6 million under this agreement, with \$50.5 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. As of June 30, 2011, the Company's European subsidiaries had bank term loans of \$6.2 million with maturities through 2015 and short-term bank debt of \$21.8 million with available short-term borrowing capacity of \$19.2 million. The Company's Latin American subsidiaries had no outstanding debt, with \$11.8 million of short-term borrowing capacity as of that date. As of June 30, 2011, the Company's Singapore subsidiary was obligated for \$13.8 million under an asset purchase agreement that took effect on November 4, 2010. The Company's majority-owned joint ventures in the Philippines and China had debt totaling \$9.7 million and available borrowing capacity of \$8.1 million. Stepan Company has guaranteed the debt obligations of its Singapore subsidiary and of its majority-owned joint ventures in the Philippines and China.

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 Stepan Company and Stepan Canada Inc. (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 \$175.0 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 in amounts of up to \$30.0 million plus 100 percent of net income and cash proceeds of stock option exercises, measured cumulatively after December 31, 2001. 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 was in compliance with all of its loan agreements as of June 30, 2011. Based on current projections, the Company believes it will be in compliance with its loan agreements throughout 2011.

#### 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 six months of 2011, the Company's expenditures for capital projects related to the environment were \$0.7 million. These projects are capitalized and depreciated over their estimated useful lives, which is 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 \$8.1 million and \$7.8 million for the six months ended June 30, 2011 and 2010, 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 \$9.4 million to \$29.2 million at June 30, 2011, compared to \$10.0 million to \$29.7 million at December 31, 2010. At June 30, 2011 and December 31, 2010, 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 \$15.9 million, respectively. Actual costs could differ from the estimated reported liability. During the first six months of 2011, cash outlays related to legal and environmental matters approximated \$2.7 million compared to \$1.6 million for the first six months of 2010. Remediation of the soil at the Poland subsidiary accounted for most of the year-over-year change (see the Poland Manufacturing Site discussion in Note 8 to the condensed consolidated financial statements).

For certain sites, estimates of the total costs of compliance or the Company's share of such costs cannot be determined; consequently, the Company is unable to predict the effect thereof on the Company's financial position, cash flows and results of operations. Management believes that in the event of one or more adverse determinations in any annual or interim period, the impact on the Company's cash flows and 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, 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 8 to the condensed consolidated financial statements for a summary of the environmental proceedings related to certain environmental sites.

#### OUTLOOK

The Company's growth initiatives are on track to deliver future earnings in 2012. Surfactant earnings will improve this year as growth from higher margin functional surfactants offsets the weakness in consumer volumes. Surfactant demand for enhanced oil recovery continues to grow. The Company's Brazil expansion is complete and will have improved contribution in the third quarter.

The significant improvement in the Company's polymers business this year is in line with management expectations. The sold out demand for polyol at the Company's German plant will continue to require imports from the Company's Illinois plant for the balance of the year due to delays in the expanded German capacity. The delays resulted from a fire in the infrastructure related to the new polyol reactor. Management believes insurance will cover repair costs and other potential losses related to the fire. The Company's polymer plant in Poland should see improved volume over the balance of the year as it begins fulfilling new customer demand.

Specialty product earnings will benefit from the Company's recently announced Lipid Nutrition product line acquisition. The acquisition should contribute to earnings this year and provide longer term synergies with the Company's existing food ingredients business.

While 2011 will have some planned higher costs associated with global growth initiatives, the Company has the opportunity to deliver full year earnings growth.

#### CRITICAL ACCOUNTING POLICIES

There have been no changes to the critical accounting policies disclosed in the Company's 2010 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 2010 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 June 30, 2011.

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 2010 Annual Report on Form 10-K.

**Item 1A Risk Factors**

There have been no material changes from the risk factors disclosed in the Company's 2010 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 second quarter of 2011:

| <b>Period</b> | <b>Total Number of Shares Purchased</b> | <b>Average Price Paid per Share</b> | <b>Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs</b> | <b>Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs</b> |
|---------------|---|-------------------------------------|---|---|
| April         |   |                                     |   |   |
| May           | 15,562                                  | \$ 64.26                            |   |   |
| June          |   |                                     |   |   |

**Item 3 Defaults Upon Senior Securities**

None

**Item 4 (Removed and Reserved)****Item 5 Other Information**

None

**Item 6 Exhibits**

- |     |                 |   |
|-----|-----------------|---|
| (a) | Exhibit 10(a)   | Stepan Company 2011 Incentive Compensation Plan, filed with the Company's Definitive Proxy Statement on Schedule 14A (Appendix A) on March 31, 2011, and incorporated herein by reference |
| (b) | Exhibit 10(a)1  | Form of Non-Qualified Stock Option Agreement under Stepan Company 2011 Incentive Compensation Plan  |
| (c) | Exhibit 10(a)2  | Form of Incentive Stock Option Agreement under Stepan Company 2011 Incentive Compensation Plan  |
| (d) | Exhibit 10(a)3  | Form of Performance Grant Agreement under the Stepan Company 2011 Incentive Compensation Plan   |
| (e) | Exhibit 10(a)4  | Form of Non-Employee Director Non-Qualified Stock Option Agreement under Stepan Company 2011 Incentive Compensation Plan  |
| (f) | Exhibit 31.1    | Certification of President and Chief Executive Officer pursuant to Exchange Act Rule 13a-14(a)/15d-14(a)  |
| (g) | Exhibit 31.2    | Certification of Vice President and Chief Financial Officer pursuant to Exchange Act Rule 13a-14(a)/15d-14(a)   |
| (h) | Exhibit 32      | Certification pursuant to 18 U.S.C. Section 1350  |
| (i) | Exhibit 101.INS | XBRL Instance Document <sup>(1)</sup>   |
| (j) | Exhibit 101.SCH | XBRL Taxonomy Extension Schema Document <sup>(1)</sup>  |
| (k) | Exhibit 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document <sup>(1)</sup>  |
| (l) | Exhibit 101.LAB | XBRL Taxonomy Extension Label Linkbase Document <sup>(1)</sup>  |
| (m) | Exhibit 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document <sup>(1)</sup>   |

<sup>(1)</sup> Pursuant to Rule 406T of Regulation S-T, this interactive data file is deemed not filed or part of a registration statement or prospectus for purpose of section 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.

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

Date: July 29, 2011

/s/ J. E. Hurlbutt  
J. E. Hurlbutt  
Vice President and Chief Financial Officer