INNOSPEC INC.
Form 10-K
March 16, 2007
Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)

OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2006

Commission file number 1-13879

INNOSPEC INC.

(Exact name of registrant as specified in its charter)

DELAWARE (State or other jurisdiction of incorporation or organization)	**98-0181725** (I.R.S. Employer Identification No.)
Innospec Manufacturing Park **Oil Sites Road** **Ellesmere Port** **Cheshire** **United Kingdom** (Address of principal executive offices)	**CH65 4EY** (Zip Code)

Registrant s telephone number, including area code: **011-44-151-355-3611**

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
N/A	N/A

Securities registered pursuant to Section 12 (g) of the Act: **Common stock, par value $0.01 per share**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes ___
No X

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes ___
No X

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 the filing requirements for the past 90 days.

Yes X
No ___

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [ ]

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer (as defined in Rule 12b 2 of the Act).

Large accelerated filer

Accelerated filer	X
Non-accelerated filer	

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes	
No	X

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the registrant as of the most recently completed second fiscal quarter (June 30, 2006) was approximately $135 million, based on the closing price of the common shares on the NASDAQ Stock Market on June 30, 2006. Shares of common stock held by each officer and director and by each beneficial owner who owns 5% or more of the outstanding common stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for any other purpose.

As of March 12, 2007, 11,917,461 shares of the registrant s common stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of Innospec Inc. s Proxy Statement for the Annual Meeting of Stockholders to be held on May 8, 2007 are incorporated by reference into Part III of this Form 10-K.

Table of Contents

TABLE OF CONTENTS

Table of Contents

CAUTIONARY STATEMENT RELATIVE TO FORWARD-LOOKING STATEMENTS

FORWARD-LOOKING STATEMENTS

This Form 10-K contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements include all statements which address operating performance, events or developments that we expect or anticipate will occur in the future. Although such statements are believed by management to be reasonable when made, caution should be exercised not to place undue reliance on forward-looking statements, which are subject to certain risks, uncertainties and assumptions. If the risks or uncertainties ever materialize or the assumptions prove incorrect, actual results may differ materially from those expressed or implied by such forward-looking statements and assumptions. Risks, assumptions and uncertainties include, without limitation, the outcome of the Company s disputes with Ethyl and the impact on the Company s tetra ethyl lead business related thereto, changes in the terms of trading with significant customers or gain or loss thereof, the effects of changing government regulations and economic and market conditions, competition and changes in demand and business and legal risks inherent in non-U.S. activities, including political and economic uncertainty, import and export limitations and market risks related to changes in interest rates and foreign exchange rates, government investigations, material fines or other penalties resulting from the Company s voluntary disclosure to the Office of Foreign Assets Control of the U.S. Department of the Treasury and other risks, uncertainties and assumptions identified in the Company s Annual Report on Form 10-K for the year ended December 31, 2006 and those identified in the Company s other reports filed with the Securities and Exchange Commission. The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Table of Contents

PART I

Item 1 Business

When we use the terms the Corporation, Company, Registrant, we, us and our, unless otherwise indicated or context otherwise requires, we are referring to Innospec Inc. and its consolidated subsidiaries (Innospec).

General

Innospec Inc. is a Delaware corporation.

On March 21, 2006 the listing of the Company s common stock was transferred from the New York Stock Exchange (NYSE) to the Nasdaq Stock Market (NASDAQ).

The Company changed its name from Octel Corp. to Innospec Inc. on January 30, 2006.

Until May 22, 1998, the Company had been a wholly owned subsidiary of Chemtura Corporation, previously known as Great Lakes Chemical Corporation (GLCC), a Delaware corporation. On May 22, 1998, GLCC consummated the spin-off of its petroleum additives business by distributing shares in the Company to the stockholders of GLCC.

Description of the Business

The Company develops, manufactures, blends and delivers fuel additives and other specialty chemicals. The Company serves global markets in the Americas, Europe, the Middle East, Africa and Asia Pacific. Its products are sold primarily to oil refineries and other chemical and industrial companies.

Segmental Information

Innospec divides its business into three distinct segments for both management and reporting purposes: Fuel Specialties, Performance Chemicals and Octane Additives. The Fuel Specialties and Performance Chemicals businesses both operate in markets where we actively seek growth opportunities albeit their end customers are very different. The Octane Additives business operates in markets which are mature with generally declining demand.

Fuel Specialties

The Fuel Specialties business develops, manufactures, blends and delivers a range of specialty chemical products used as additives to a wide range of fuels. The business specializes in supplying fuel additives that help improve fuel efficiency, boost engine performance and reduce harmful emissions. The business s products are used in the efficient operation of automotive, marine and aviation engines, power station generators, and heating and diesel particulate filter systems.

Historically the business has grown through a program of mergers and acquisitions. This program has included the establishment in 1999 of a 50% owned joint venture with Starreon

Table of Contents

LLC to sell fuel additives in the USA and the subsequent acquisition of the remaining 50% of that joint venture in July 2004. In November 2004, the Company disposed of certain manufacturing and other assets held by our Swedish subsidiary, Innospec Bycosin AB. The Company has also established a joint venture in Valvemaster® Limited.

More recently growth has been driven by new product development to address what we believe are the key drivers to demand for fuel additives. These key drivers are legislation, population affluence, and energy price and availability.

Performance Chemicals

The Performance Chemicals business includes a range of companies who manufacture performance chemicals used in a wide range of industrial processes and everyday products. Our products range from the well-known Finetex brands of surfactants and emollients to numerous synthetic aromas, including the widely used synthetic Lilestralis® fragrance. We also manufacture Octaquest®, a biodegradable chelating agent, Octastat®, the anti-static additive, and the successful Leuna Polymer branded waxes.

These additives are used in the manufacture of such items as personal care products through to household detergents and crop protection chemicals. They are also used in the manufacture of plastics, paper and in the metal plating and oil industries. Many of our additives are key ingredients in our customers products, improving performance and differentiating the customer s product from its competitors. Other additives are designed to provide specific solutions to common manufacturing problems such as static build up during certain industrial processes.

Historically the business has grown through a program of mergers and acquisitions. This program has included the acquisition of Finetex, Inc. in January 2005, Aroma & Fine Chemicals Limited in August 2004 and Leuna Polymer GmbH in June 2004. In December 2005, the Company disposed of two non-core businesses, Octel Performance Chemicals Inc. and the Gamlen Industries SA waste water treatment business. Effective January 1, 2007 the businesses of Finetex, Inc. and ProChem Chemicals, Inc. were merged into Innospec Performance Chemicals U.S. Co. in order to realize potential significant benefits from their complementary areas of expertise and competency.

The Performance Chemicals focus going forward is to develop high performance products from its technology base complemented by selective acquisitions to achieve critical mass in a number of markets.

Octane Additives

The Octane Additives business is the world s only producer of tetra ethyl lead (TEL). The Octane Additives business comprises sales of TEL for use in automotive gasoline and trading in respect of our environmental remediation business.

Table of Contents

TEL was first developed in 1928 and introduced into the European market for internal combustion engines to boost octane levels in gasoline allowing it to burn more efficiently and eliminating engine knock. It also acts as a lubricity aid reducing engine wear. Worldwide use of TEL has declined since 1973 following the enactment of the U.S. Clean Air Act of 1970 and similar legislation in other countries. The trend of countries exiting the leaded gasoline market has resulted in a general rate of decline in volume terms in the last few years of between 10% and 25% per annum. The decline experienced in 2006 was greater than this general range due to the decision of South Africa to exit the market for use of TEL in automotive gasoline from that start of 2006.

The Company intends to manage the decrease in the sales of TEL for use in automotive gasoline to maximize the cash flow through the decline. Continuous cost improvement measures have been, and will continue to be, taken to respond to declining market demand.

Our environmental remediation business assists customers to manage the clean up of the associated redundant plants as refineries make the change to unleaded fuel.

Raw Materials and Product Supply

We use a variety of raw materials and chemicals in our manufacturing and blending processes and believe the sources of these are adequate for our current operations. Our major purchases are ethylene, sodium, lead, cetane number improvers, ethyl chloride, various solvents and dibromoethane.

These purchases account for a substantial portion of the Company s manufacturing costs. These materials are, with the exception of ethylene in Germany, readily available from more than one source. We use long-term contracts (generally with fixed prices and escalation terms) to help ensure availability, continuity of supply and manage the risk of price increases.

The chemical industry, in general, is experiencing some tightness in the supply of certain commodity materials. We continue to monitor the situation and adjust our procurement strategies as we deem appropriate.

Intellectual Property

Our intellectual property, including trademarks, patents and licences, forms a significant part of the Company s competitive strengths particularly in the Fuel Specialties and Performance Chemicals businesses. The Company does not however consider its business as a whole to be dependent on any one trademark, patent or licence.

The Company has a portfolio of trademarks and patents, granted and in the application stage, covering products and processes in several jurisdictions. The majority of these patents were developed by the Company and, subject to maintenance obligations including the payment of renewal fees, have at least ten years life remaining.

The Company also holds a license for the manufacture of fuel detergents. The trade mark Innospec and the Innospec device in Classes 1, 2 and 4 of the International Classification of

Table of Contents

Goods and Services for the Purposes of the Registration of Marks is registered in all countries/jurisdictions in which it has a significant market presence. The Company also has trademark registrations for Octaquest® in all countries/jurisdictions in which it has a significant market presence.

Innospec International Limited, a subsidiary of the Company, has trademarks for Stadis®, a conductivity improver, and Ocenol®, an antifoam for refinery use. Innospec Limited, also a subsidiary of the Company, has trademarks for Valvemaster®, a valve seat recession additive.

We actively protect our inventions, new technologies, and product developments by filing patent business applications or maintaining trade secrets. In addition, we vigorously participate in patent opposition proceedings around the world, where necessary, to secure a technology base free of infringement. We believe our patent position is strong, well managed, and sufficient for the conduct of our business.

Customers

Fuel Specialties

Our customers are multinational oil companies and fuel retailers. Traditionally, a large portion of the total market was captive to oil companies that had fuel additives divisions providing supplies directly to their respective refinery customers. As a result of various corporate restructurings and arrangements, involving downstream refining and marketing operations, the tied supply arrangements between oil companies and their captive fuel additive divisions have been weakened. Accordingly, many refineries are increasingly looking to purchase their fuel additive requirements on the open market. This trend is creating new opportunities for independent additive marketers such as us.

Performance Chemicals

Customers range from large multinationals and manufacturers of personal care and household products, to specialty chemical manufacturers operating in niche industries.

Octane Additives

Sales of TEL for use in automotive gasoline are made principally to the retail refinery market which comprises independent, state or major oil company owned refineries located throughout the world. Selling prices to major customers are usually negotiated under long-term supply agreements with varying prices and terms of payment. Our environmental remediation business then serves these customers to manage the clean up of the associated redundant plants as refineries make the change to unleaded fuel.

In 2006 and 2005 no single customer accounted for more than 10% of net sales. In 2004 the Company had one significant customer in the Octane Additives business who accounted for $65.7 million (13%) of net sales. In the second quarter of 2005 this customer permanently left the market for TEL for use in automotive gasoline.

Table of Contents

Competition

Fuel Specialties

The Fuel Specialties market is fragmented and characterized by a small number of competitors in each submarket. The competitors in each submarket differ with no one company holding a dominant position. We consider our competitive strengths to be our strong technical development capacity, independence from major oil companies and strong long-term relationships with refinery customers.

Performance Chemicals

We operate in a number of performance chemical market niches. Accordingly, there are a plethora of competitors who also operate in some but not all of these markets.

Octane Additives

The Octane Additives business is the world s only producer of TEL and accordingly is the only supplier of TEL for use in automotive gasoline. The business therefore competes with marketers of products and processes that provide alternative ways of enhancing octane performance in automotive gasoline.

Agreements with Ethyl Corporation

Innospec supplies TEL to Ethyl Corporation (Ethyl), a subsidiary of NewMarket Corporation, on a wholesale basis under a long-term supply agreement for resale to customers in the United States.

On October 1, 1998, the Company entered into sales and marketing agreements with Ethyl to market and sell TEL in all areas of the world except North America and the European Economic Area for the period lasting until December 31, 2009, subject to renewal thereafter. All marketing and sales effort made under the arrangement is made in the name of Innospec. Innospec continues to produce all TEL marketed under the agreements and also provide marketing and other services. Ethyl continues to provide marketing and other services. The net proceeds under the agreements are paid to Innospec and Ethyl as compensation for services and are based on an agreed-upon formula**,** with Innospec receiving 68% of the total compensation for services provided. This relationship was extended effective

January 1, 2000 when OBOAdler entered into a similar agreement. Effective July 1, 2001 Ethyl agreed to participate in the Veritel agreement (see Note 10 of the Notes to the Consolidated Financial Statements) and the scope of the agreements was extended to include the European Economic Area. For a discussion of litigation between Ethyl and the Company, see Legal Proceedings below.

Research, Development and Testing

Research, development and testing (R&D) provide the basis for the growth of our Fuel Specialties and Performance Chemicals businesses. Accordingly, the Company s R&D

activity has been, and will continue to be, focused on the development of new products and formulations for these. Technical support is provided for all of our businesses, including Octane Additives, to assure total customer satisfaction.

The Company s principal research and development facilities are located in Ellesmere Port, U.K. Expenditures to support research, product/application development and technical support services to customers were $11.1 million, $11.2 million, and $10.1 million in 2006, 2005, and 2004, respectively.

The Company considers that its strong technical capability provides it with a significant competitive advantage. In the last three years, the Fuel Specialties business has developed new detergent, lubricity and combustion improver products, in addition to the introduction of several new cost effective fuel additive packages. A patented process for manufacturing Octaquest®, a chelating agent, enabled the Company to enter into a new market in the performance chemicals area.

Health, Safety and Environmental Matters

The Company is subject to environmental laws in all of the countries in which it does business. The principal environmental laws to which the Company is subject to in the U.K. are the Environmental Protection Act 1990, the Water Resources Act 1991, the Health and Safety at Work Act 1974 and regulations and amendments thereto. Management believes that the Company is in material compliance with all applicable environmental laws and has made appropriate provision for the continued costs of compliance with environmental laws. Nevertheless, there can be no assurance that changes in existing environmental laws, or the discovery of additional liabilities associated with the Company s current or former operations, will not have a material adverse effect on the Company s business, results of operations or financial position.

The principal sites giving rise to environmental remediation liabilities are the former Octane Additives manufacturing sites at Paimboeuf in France, Doberitz and Biebesheim in Germany, together with the Ellesmere Port site in the U.K., which is the last ongoing manufacturer of TEL. Remediation work is substantially complete at Paimboeuf, Doberitz and Biebesheim. At Ellesmere Port there is a continuing remediation program related to those manufacturing units that have been closed. The Company regularly reviews the future costs of remediation and the current estimate is reflected in Note 13 of the Notes to the Consolidated Financial Statements.

The Company records environmental liabilities relating to the retirement of assets and environmental clean up when they are probable and costs can be estimated reasonably. This involves anticipating the program of work and the associated future costs, and so involves the exercise of judgement by management.

Human Resources

The Company s workforce at December 31, 2006 consisted of 774 employees, of which 377 were in the U.K. Approximately 40% of the Company s employees in the U.K. are represented by unions, including the Transport and General Workers Union and AMICUS.

The Company has in place an employee communication program to help its employees understand the business issues surrounding the Company, the corporate restructuring that has been implemented to respond to declining TEL demand and to the developing Fuel Specialties and Performance Chemicals businesses. Regular briefings are conducted by the CEO and line managers where Company-wide and departmental issues are discussed. More formal communication takes place with the trade unions recognized by the Company for negotiating and consultative purposes.

Available Information

We file with the Securities and Exchange Commission (SEC) under the Securities Exchange Act of 1934, as amended (the Exchange Act) our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to those reports, proxy statements and other documents. The public may read and copy any materials that we file with the SEC at the SEC s Public Reference Room at 100 F Street, N.E., Washington, D.C. 20549, United States of America. The public may also obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. In addition, the SEC maintains an Internet website at www.sec.gov that contains reports, proxy and information statements and other information that registrants, including the Company, file electronically with the SEC.

Our corporate website is www.innospecinc.com. We make available, free of charge, on or through this website our annual, quarterly and current reports, and any amendments to those reports, as soon as reasonably practicable after electronically filing such material with, or furnishing it to, the SEC. In addition, Innospec s Corporate Governance Guidelines, Code of Ethics and Director Independence standards, and the written charters for the committees of Innospec s Board of Directors are available on this website under About Us Corporate Governance and in print upon request by writing to: Corporate Secretary, Innospec Inc., Innospec Manufacturing Park, Oil Sites Road, Ellesmere Port, Cheshire, United Kingdom, CH65 4EY.

None of the above available information forms part of this filing on Form 10-K, unless specifically incorporated by reference elsewhere in this Form 10-K.

Item 1A Risk Factors

Our business is subject to many factors that could materially adversely affect our future performance and cause our actual results to differ materially from those experienced or implied by forward-looking statements made in this Annual Report on Form 10-K.

Investing in our securities involves risks and accordingly investors should carefully evaluate these risks including the factors discussed below before deciding to invest in our securities.

Competition and market conditions may adversely affect our operating results.

Certain product lines and markets in which the Company s businesses operate are subject to significant competition. The Company competes on the basis of a number of factors including, but not limited to, product quality and properties, customer relationships and service, and regulatory and toxicological expertise. For some products the competitors are larger than us and may have greater access to financial, technological and other resources. As a result these competitors may be able to better withstand a change in conditions within the industries in which the Company operates, a change in the prices of raw materials or a change in global economic conditions. Competitors may be able to introduce new products with enhanced features that may cause a decline in the demand and sales of the Company s products. Consolidation of customers or competitors in the market areas in which the Company operates may cause a loss of market share for the Company s products or place downward pressure on prices. Any of these risks could negatively impact our future revenues, gross margins and cash flows from operating activities.

Sharp and unexpected fluctuations in the cost of our raw materials and energy could adversely affect our profit margins.

We use a variety of raw materials, chemicals and energy in our manufacturing and blending processes. Many of the raw materials that we use are derived from petrochemical-based feedstocks which can be subject to periods of rapid and significant price instability. These fluctuations in price can be caused by political instability in oil producing nations and elsewhere, or other factors influencing global supply and demand over which we have no or little control. Innospec does not typically enter into hedging arrangements with respect to raw materials, chemicals or energy costs. Should costs of raw materials, chemicals or energy increase, and should Innospec s businesses not be able to pass on these cost increases to our customers, then operating margins and cash flows from operating activities would be negatively impacted. Should raw material prices increase significantly, then the Company s need for working capital could increase which would negatively impact cash flows from operating activities.

A disruption in the supply of raw materials or transportation services would have a material adverse effect on our results of operations.

The chemical industry and transportation industry are in a situation where the supply and demand of both transportation services and the supply and demand of raw materials are in balance. Any significant disruption in supply could affect our ability to obtain raw materials or transportation services. This could negatively impact our results of operations, financial position and cash flows from operating activities.

We could be adversely affected by technological changes in our industry.

Our ability to maintain or enhance our technological capabilities, develop and market products and applications that meet changing customer requirements, and successfully anticipate or respond to technological changes in a cost effective and timely manner will likely impact our future business success. Technological changes in some or all of our customers products or processes may make our products obsolete and accordingly adversely impact our results of operations, financial position and cash flows.

Table of Contents

Our Octane Additives business will continue to decline.

Worldwide use of TEL has declined since 1973 following the enactment of the U.S. Clean Air Act of 1970 and similar legislation in other countries. The trend of countries exiting the leaded gasoline market has resulted in a general rate of decline in volume terms in recent years of between 10% and 25% per annum. The predicted remaining sales of the Octane Additives business are now concentrated in a relatively small number of customers and may decline with unpredictable volatility and severity. Should one or more of these customers choose for economic, environmental, political or other reasons to cease using TEL as an octane enhancer earlier than has been anticipated, then the Company s future operating income and cash flows from operating activities would be negatively impacted. There could also be an accelerated write-off of Octane Additives business goodwill as the forecast discounted cash flows from that business would be reduced. The Company anticipates that eventually all countries in the world will stop the use of TEL in automotive gasoline. The Company expects that it will cease all sales of TEL for use in automotive gasoline at some time in the future.

We face risks related to our foreign operations that may negatively affect our business.

We serve global markets and accordingly operate in some countries which do not have stable economies or governments. Specifically, we trade in countries experiencing political and economic instability in the Middle East and Asia Pacific. Our international operations are subject to international business risks including, but not limited to, unsettled political conditions, expropriation, import and export restrictions, exchange controls, national and regional labor strikes, taxes, government royalties and restrictions on repatriation of earnings or proceeds from liquidated assets of foreign subsidiaries. The occurrence of any, or a combination, of these events could negatively impact our results of operations, financial position and cash flows from operating activities.

We are exposed to fluctuations in foreign exchange rates, which may adversely affect our results of operations.

The Company generates revenues and incurs operating costs in currencies other than the U.S. dollar. In addition, the financial position and results of operations of some of our foreign subsidiaries are reported in the relevant local currency and then translated to U.S. dollars at the applicable currency exchange rate for inclusion in our consolidated financial statements. Changes in exchange rates between these foreign currencies and the U.S. dollar will affect the recorded levels of our assets and liabilities, to the extent such figures reflect the inclusion of foreign assets and liabilities that are translated into U.S. dollars for presentation in our financial statements, as well as our results of operations.

The primary foreign currencies in which we have exchange rate fluctuation exposure are the European Union euro and British pound sterling. The Company cannot accurately predict the nature or extent of future exchange rate variability. While the Company takes steps to manage currency exposure by entering into hedging transactions, this cannot eliminate all exposure to future exchange rate variability. Exchange rates between these currencies and the U.S. dollar

Table of Contents

have fluctuated significantly in recent years and may continue to do so in the future, which could materially impact our results of operations and financial position.

Failure to protect our intellectual property rights could adversely affect our future performance and cash flows.

Our intellectual property, including trademarks, patents and licences, forms a significant part of the Company s competitive strengths. We therefore depend on our ability to develop and protect our intellectual property rights to distinguish our products from those of our competitors. Failure to do so may result in the loss of valuable technologies, or our having to pay other companies for infringing their intellectual property rights. Measures taken by us to protect our intellectual property may be challenged, invalidated, circumvented or rendered unenforceable. We may also face patent infringement claims from our competitors which may result in substantial litigation costs, claims for damages or a tarnishing of our reputation even if we are successful in defending these claims, which may cause our customers to switch to our competitors. The occurrence of any, or a combination, of these events could negatively impact our results of operations, financial position and cash flows from operating activities.

We are subject to extensive government regulation.

We are subject to regulation by local, state, federal and foreign governmental authorities. In some circumstances these authorities must approve our products, manufacturing processes and facilities before we may sell certain products. Many of the Company s products are required to be registered with the U.S. Environmental Protection Agency (EPA) and with comparable governmental agencies elsewhere. We are also subject to ongoing reviews of our products, manufacturing processes and facilities by governmental authorities including the requirement to produce product data.

In order to obtain regulatory approval of certain new products we must, amongst other things, demonstrate to the relevant authority that the product is safe and effective for its intended uses, and that we are capable of manufacturing the product in accordance with current regulations. This approval process can be costly, time consuming, and subject to unanticipated and significant delays. Accordingly, there can be no assurance that approvals will be granted on a timely basis, or at all. Any delay in obtaining, or any failure to obtain or maintain, these approvals would adversely affect our ability to introduce new products and to generate income from those products.

New laws and regulations may be introduced in the future that could result in additional compliance costs and prevent or inhibit the development, distribution and sale of our products. The European Union has approved additional legislation known as the Registration, Evaluation and Authorization of Chemical Substances Regulations (REACH) which requires most of the Company s products to be registered with EU Authorities. Under this legislation the Company has to demonstrate the continuing safety of its products. During this registration period the Company will incur expense to test and register its products. The Company estimates that the cost of complying with REACH will be no more than $5 million

incurred over the next 3 to 5 year period. While the Company expects that its products will be approved for registration after testing it is possible that certain products may not be registered if the test data proves unsatisfactory. In such an outcome some of the Company s products may be restricted or prohibited in the EU. This could have a material impact on our results of operations, financial position or cash flows.

The Company is currently the subject of an inquiry by the SEC into potential violations of federal securities law as a result of transactions conducted by the Company s wholly owned indirect subsidiary, Alcor Chemie Vertriebs GmbH, under the United Nations Oil for Food Program. Separately, the Company has made a voluntary disclosure to U.S. Office of Foreign Assets Control (OFAC) regarding dealings with Cuba by certain of the Company s current and former subsidiaries. The Company has made provision for legal expenses and potential penalties in respect of these matters to the extent this is feasible. However should the Company s estimates prove to be inadequate then this could have a material impact upon the Company s operating income and cash flows from operating activities.

Legal proceedings and other claims, including proceedings against Ethyl, could impose substantial costs on us.

We are occasionally involved in legal proceedings that result from, and are incidental to, the conduct of our business, including product liability claims. We have insurance coverage to mitigate any potential damages in any such proceedings, however if our insurance did not cover such claims, then this could have a material adverse effect on our results of operations, financial position and cash flows.

Additionally, we are involved in a number of arbitrations in the London Court of International Arbitration against Ethyl. In the first of these proceedings, which relate to supplies of TEL to the United States, we are seeking to increase the price of TEL charged to Ethyl. In the further arbitration proceedings, we are seeking to terminate the sales and marketing agreements governing the global sales and marketing of TEL outside North America. We are additionally claiming in excess of $40 million damages because we believe Ethyl has violated the agreements. We remain confident in our position, however costs may be substantial, although we do not believe they will have a material adverse effect on our results of operations, financial position and cash flows.

Environmental matters could have a substantial negative impact on our results of operations.

The Company is subject to extensive federal, state, local and foreign environmental, health and safety laws and regulations concerning emissions to the air, discharges to land and water and the generation, handling, treatment and disposal of hazardous waste and other materials. The Company is also required to obtain various environmental permits and licenses many of which require periodic notification and renewal.

The Company operates on a number of manufacturing sites. The Company s historic operations, and the historic operations of companies who have previously operated on sites that the Company has acquired, entail the risk of environmental contamination of the properties that it owns or has owned. This may result in fines or criminal sanctions against the Company or may entail the Company in material costs to remediate historic contamination.

The Company further anticipates that certain production facilities may cease production in the medium to long-term. On closure of some of these production operations in the future, the Company expects to be subject to environmental laws that will require production facilities to be safely decommissioned and a degree of environmental remediation to be undertaken. The degree of environmental remediation will depend upon the plans for the future use of the operating sites that are affected and the environmental legislation in force at the time. The Company has currently made a decommissioning and remediation provision based on the Company s current obligations, the current plans for those sites and current environmental legislation. Should the Company s future plans for the sites change or should environmental legislation change then these provisions may prove inadequate and this will have a negative impact on future operating income and cash flows from operating activities.

The terms of our credit agreements may restrict our ability to incur additional indebtedness or to otherwise expand our business.

The Company s existing credit facilities contain restrictive clauses which may constrain our activities and limit our operational and financial flexibility. These clauses limit our ability, among other matters, to increase indebtedness, use assets as security in other transactions, dispose of assets, acquire assets or investments, and pay dividends or repurchase common stock.

The current credit facilities require the Company to meet certain financial ratios including net debt to EBITDA (as defined in the credit facility) and net interest expense to EBITA (as defined in the credit facility). The ability to meet these financial covenants depends upon the future operating performance of the businesses. If the Company fails to meet target covenants then it would be in technical default on the borrowing facility and the maturity of the outstanding debt could be accelerated unless it were able to obtain waivers from the lenders.

The Company expects to need to refinance some of the existing debt at the end of the remaining two and a half year term of the current borrowing facility. Should the Company not be able to secure refinancing on satisfactory terms at that point this may adversely impact continuing operations.

Our business is subject to the risk of production or transportation interruptions, the occurrence of any of which would adversely affect our results of operations.

We are subject to hazards common to chemical manufacturing, blending, storage, handling and transportation including fires, explosions, mechanical failure, transportation interruptions, remediation, chemical spills and the release or discharge of toxic or hazardous substances. These hazards could result in loss of life, property damage, environmental contamination and temporary or permanent production cessation. Any, or a combination, of these factors could

Table of Contents

negatively impact our results of operations, financial position and cash flows from operating activities.

We may be required to make additional contributions to the defined benefit pension scheme that we operate in the United Kingdom.

The Company operates a contributory defined benefit plan in the United Kingdom. The plan is closed to new entrants, without trustee discretion, but has a large number of deferred and current pensioners. Should future investment returns prove insufficient to meet future obligations, or should future obligations increase due to actuarial factors or changes in pension legislation, then the Company may be required to make additional cash contributions. This could have a material impact on future operating income and cash flows from operating activities.

Domestic or international natural disasters or terrorist attacks may disrupt our operations, decrease the demand for our products or otherwise have a negative impact on our business.

Chemical related assets, and United States corporations such as ourselves, may be at greater risk of future terrorist attacks than other possible targets in the United States, United Kingdom and throughout the world. The occurrence of such events cannot be predicted though they can be expected to continue to negatively impact the economy in general and our specific markets. The resulting damage from such an event could include loss of life, property damage or site closure. Any, or a combination, of these factors could negatively impact our results of operations, financial position and cash flows from operating activities.

Item 1B Unresolved Staff Comments

None.

Table of Contents

Item 2 Properties

A summary of the Company s principal properties is shown in the following table. Each of these properties is owned by the Company except where otherwise noted:

Location	*Business and Business Segment*	*Operations*
Newark, Delaware, U.S. (1)	Innospec Inc. Corporate	Corporate Headquarters
Ellesmere Port, U.K.	Innospec Inc. and Innospec Limited Fuel Specialties, Performance Chemicals and Octane Additives	European Headquarters Business Teams Manufacturing/Administration Research & Development Fuel Technology Center
Widnes, U.K.	Aroma Fine Chemicals Limited Performance Chemicals	Manufacturing/Administration
Herne, Germany (1)	Innospec Deutschland GmbH Fuel Specialties	Manufacturing/Administration
Leuna, Germany	Innospec Leuna GmbH Fuel Specialties and Performance Chemicals	Manufacturing/Administration
Vernon, France	Innospec France SA Fuel Specialties	Manufacturing/Administration
Zug, Switzerland (1)	Alcor Chemie Vertriebs GmbH Octane Additives	Sales/Administration
Littleton, Colorado (1)	Innospec Fuel Specialties LLC Fuel Specialties	Sales/Administration
High Point, North Carolina (1)	Innospec Performance Chemicals U.S. Co. Performance Chemicals	Manufacturing/Administration
Spencer, North Carolina (1)	Innospec Performance Chemicals U.S. Co. Performance Chemicals	Manufacturing/Administration

(1) Leased property

The headquarters of Innospec Inc. is located at 220 Continental Drive, Newark, DE 19713.

Production Capacity

We believe that our plants and supply agreements are sufficient to meet expected future sales levels. Operating rates of the plants are generally flexible and varied with product mix and normal sales swings. Specifically, we believe our Octane Additives manufacturing site at Ellesmere Port, U.K. can be managed in a flexible and cost effective manner in order to meet anticipated future demand. We believe that all of our facilities are well maintained and in good operating condition.

Table of Contents

Item 3 Legal Proceedings

Bycosin Disposal

Voluntary disclosure of possible violations of the Cuban Assets Control Regulations to the Office of Foreign Assets Control. Given the international scope of its operations, the Company is subject to laws of many different jurisdictions, including laws relating to the imposition of restrictions on trade and investment with various entities, persons and countries, some of which laws are conflicting. In 2004 the Company reviewed, as it does periodically, aspects of its operations in respect of such restrictions, and determined to dispose of certain non-core, non-U.S. subsidiaries of Bycosin AB. Bycosin s non-U.S. subsidiaries had been engaged in transactions and activities involving Cuban persons and entities before the acquisition of the Bycosin Group by the Company in June 2001, and such subsidiaries were continuing to engage in such transactions and activities at the time of the disposal of the non-core Fuel Specialties business and related assets in November 2004. On November 15, 2004, Bycosin AB, a wholly-owned subsidiary of the Company organized under the laws of Sweden (now known as Innospec Sweden AB, the Seller), entered into a Business and Asset Purchase Agreement (the Agreement) with Pesdo Swedcap Holdings AB (the Purchaser), Håkan Byström and others as the Purchaser s guarantors, and Octel Petroleum Specialties Limited (now known as Innospec Fuel Specialties Limited) as the Seller s guarantor, and completed the all-cash transaction contemplated thereby (together with related transactions, the Transaction). The Agreement provided for, among other things: (i) the disposal of certain non-core Fuel Specialties business and related manufacturing and other assets of the Seller; and (ii) the supply and distribution of certain power products to certain geographic regions. The net consideration paid by the Purchaser was approximately US$2.9 million.

Following completion of the Transaction, the Company made a voluntary disclosure to the U.S. Office of Foreign Assets Control (OFAC) regarding transactions and activities engaged in by certain non-U.S. subsidiaries of the Company. The Company conducted an internal review of such transactions and activities and, in March 2005, disclosed to OFAC the preliminary results of such review. Thereafter, OFAC requested certain additional information relating to the Bycosin disclosure, and, in May 2005, the Company provided OFAC with such additional information. During the course of its internal review, the Company obtained additional details relating to the previously disclosed Bycosin business and information concerning a series of unrelated transactions involving the sale of TEL by its subsidiary The Associated Octel Company Limited (now known as Innospec Limited) to a Cuban entity. Such sales of TEL ended in 1999. The Company informed OFAC of its receipt of this additional information in June 2005. On January 27, 2006, the Company submitted additional information to OFAC regarding this matter. The Company s internal review identified, among other things, that: (i) Bycosin s non-U.S. subsidiaries maintained an office in Cuba from which they conducted their fuel additive sales, and other related activities; (ii) Innospec Limited employees travelled to Cuba for business-related purposes with respect to the Bycosin sales on two occasions and consulted with representatives of Bycosin s non-U.S. subsidiaries regarding substantial contracts with the Cuban customers; (iii) Gamlen Industries, S.A., a French company and an indirect subsidiary of the Company, sold fuel additive products to a

Table of Contents

Bycosin subsidiary that were delivered to a Cuban customer on four occasions; (iv) Innospec Limited was involved in the direct and indirect sale of TEL products to one principal Cuban customer between 1991 and 1999, and, although the last sale of TEL was in April 1999, certain ancillary aspects primarily related to discontinuing these commercial relationships continued until January 2002 and (v) the aggregate monetary value of the transactions involving Cuban persons and entities conducted by the Company s non-U.S. subsidiaries since January 1999 is approximately $26.6 million. The Company is continuing to cooperate on a voluntary basis with OFAC s review of its voluntary disclosure.

The Cuban Assets Control Regulations (31 CFR Part 515) (CACR) were issued by the U.S. Government under the Trading With the Enemy Act as amended (50 U.S.C. App. 5(b)). These regulations, in conjunction with the Helms-Burton Act, generally prohibit persons subject to the jurisdiction of the United States , which includes foreign subsidiaries of U.S. companies, from engaging in business and transactions with Cuba. However compliance with the CACR by European companies is prohibited by Council Regulation No. 2271/96 adopted by the Council of the European Union in November 1996. The U.S. regulations and the European regulations conflict with each other in certain respects. The Company cannot predict how OFAC will interpret the implementation of the CACR or other relevant laws or regulations with respect to the commercial activities involving Cuba of the Company s former non-U.S. subsidiaries. While the Company believes that it is no longer engaged in business with certain entities, persons and countries that are subject to restrictions and sanctions under U.S. trade laws and regulations and that it has taken appropriate steps to achieve compliance with applicable U.S. laws and regulations relating to trade and investment, if the Company or its subsidiaries (current or former) were found not to have complied with such laws or regulations, or any other applicable laws or regulations, including those of jurisdictions the laws of which are conflicting, the Company or its subsidiaries could be subject to fines or other civil or criminal penalties which could be material.

At this time, however, management believes that it would be speculative and potentially misleading for the Company to predict the specific nature or amount of penalties that OFAC might eventually assess against it. While penalties could be assessed on different bases, if OFAC assessed penalties against the Company on a performance of contracts basis , the applicable regulations provide for penalties, in the case of civil violations of the CACR, of the lesser of $65,000 per violation or the value of the contract. Since January 1999, non-U.S. subsidiaries of the Company have entered into 43 contracts with Cuban entities, each of which could be considered a separate violation of the CACR by OFAC. OFAC may take the position that the CACR should be interpreted or applied in a different manner, potentially even to permit the assessment of penalties equal to or greater than the value of the business conducted with Cuban persons or entities.

As of the date hereof, the Company has not had any discussions with OFAC regarding the nature or amount of penalties to which it might be subject, or how such penalties might be calculated, including whether OFAC might assess penalties for transactions performed before January 1999. The Company has considered the range of possible outcomes and potential penalties payable. In accordance with the Company s accounting policies, provision has been made for management s current best estimate of the potential liability, including anticipated legal costs. However, should the underlying assumptions prove incorrect, the actual outcome could differ materially from management s current expectations. Management is not able to estimate the range of any additional loss, if any.

Management believes that at this time it is still not able to predict with any certainty how OFAC will calculate the number of possible violations of the CACR that may have occurred or the nature or amount of penalties to which the Company could be subject. First, while the Bycosin sales occurred within the last five years, virtually all of Innospec Limited s TEL sales and transactions with Cuba occurred more than five years ago and, thus, may be outside the statute of limitations period established by the relevant laws. Second, OFAC s penalty guidelines permit mitigation from the maximum penalty amount based on a company having made a voluntary disclosure. However, at this time, it is not possible to determine whether OFAC will agree that the Company should qualify for mitigation because of its voluntary disclosure. Third, the regulations do not indicate what approach OFAC might take in regards to assessing penalties against a company whose options for extricating its foreign subsidiaries from the commercial relationships with Cuba were limited by the Council Regulation No. 2271/96 adopted by the Council of the European Union and the Mexican blocking measures. Thus, we cannot speculate as to how OFAC might characterize these possible violations nor can we predict the timing of further developments or the final outcome of the voluntary disclosure to OFAC. Management believes that if the Company or its subsidiaries were found not to have complied with the CACR for past activities, the Company could be subject to fines or other civil or criminal penalties which could be material, and the Company s reputation could be damaged. In addition, actual or potential investors that object to the Company s former arrangements and contracts involving Cuba may adversely affect the price of the Company s shares by disposing of or deciding not to purchase the Company s shares.

The Chief of the Office of Global Security Risk (OGSR) of the Securities and Exchange Commission s (SEC) Division of Corporation Finance sent a letter to the Company dated November 22, 2005 (SEC comment letter) regarding its Form 10-K for the fiscal year ended December 31, 2004 and Form 10-Q for the quarter ended June 30, 2005. The SEC comment letter focused on matters arising from the Company s voluntary disclosure to OFAC. In response to the SEC comment letter, the Company submitted a letter to OGSR on December 14, 2005 and continued to be in correspondence with OGSR, regarding the submission of further information concerning its voluntary disclosure to OFAC during 2006. On November 13, 2006 the OGSR confirmed to the Company that it has no further comments on the Company s disclosure in this matter.

Patent actions

The Company is actively opposing certain third party patents in various regions of the world. The actions are part of the Company s ongoing management of its intellectual property portfolio. The Company does not believe that any of these actions will have a material effect on the financial position or results of operations of the Company.

Table of Contents

Oil For Food

On February 7, 2006, the SEC notified the Company that it had commenced an inquiry to determine whether any violations of federal securities law had occurred in connection with transactions conducted by the Company, including its wholly owned indirect subsidiary, Alcor Chemie Vertriebs GmbH (Alcor), a Swiss company, under the United Nations Oil for Food Program between June 1, 1999 and December 31, 2003. As part of its inquiry, the SEC issued a subpoena requiring the production of certain documents, including documents relating to these transactions, by the Company and Alcor. The Company, and its officers and directors, are cooperating with the SEC inquiry. At this time, management is not able to predict whether the SEC will seek to impose any fines or penalties in this matter if the Company or its subsidiaries is found not to have complied with the relevant laws.

Dispute with Ethyl Corp.

The Company is currently disputing the price that it is entitled to charge for the supply of TEL in North America to Ethyl Corporation (Ethyl), a subsidiary of NewMarket Corporation. This dispute is the subject of arbitration proceedings in the London Court of International Arbitration (LCIA). Pursuant to these proceedings, an interim order was made on September 29, 2006 requiring Ethyl to pay the increased price claimed by the Company into an escrow account pending final determination of the arbitration. The difference in prices that the Company is claiming is equivalent to approximately $3 million on an annualized basis. At December 31, 2006, Ethyl had placed approximately $1.7 million into the escrow account in respect of TEL product supplied by us during the nine months ended September 30, 2006.

The Company has also commenced proceedings in the LCIA against Ethyl regarding its marketing agreements for the supply of TEL covering the rest of the world. The Company and Ethyl are parties to certain exclusive marketing agreements governing the global marketing and sale of TEL, except in North America. One obligation on both parties is to refrain from conducting any business in their own interests that might defeat or damage the purpose of these agreements. The Company believes Ethyl has breached this duty by actively marketing and selling an alternative product. As a result, the Company is claiming damages in excess of $40 million, as well as the right to terminate these agreements.

The Company is confident in its position on these matters and believes that it will prevail. Regardless of the outcome, the Company does not believe that the disputes will have a material adverse effect on the financial position or results of operations of the Company.

Other Matters

We are involved from time to time in claims and legal proceedings that result from, and are incidental to, the conduct of our business including product liability claims. At December 31, 2006 the only claim of any potential consequence, in which we are involved, is a potential claim, which could total up to approximately $4 million, indicated by one customer that we supplied them with products that did not meet their specifications. We have denied such claim and to date legal proceedings have not been issued. Whilst it is not possible to predict the outcome of such a matter we are confident in our position. In addition, we have insurance coverage to mitigate any potential damages.

Table of Contents

Except as described above, there are no other material pending legal proceedings to which the Company or any of its subsidiaries is a party, or of which any of their property is subject, other than ordinary, routine litigation incidental to their respective businesses.

Item 4 Submission of Matters to a Vote of Security Holders

No matter was submitted to a vote of security holders during the quarter ended December 31, 2006.

Table of Contents

PART II

Item 5 Market for Registrant s Common Equity, Related Stockholder Matters, and Issuer Purchases of Equity Securities

Market Information and Holders

The Company s common stock is listed on NASDAQ (symbol IOSP). As of March 12, 2007 there were approximately 1,627 registered holders of the common stock. The following table shows the high and low prices of our common stock for each of the last eight quarters.

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2006				
High	$ 26.10	$ 27.21	$ 30.14	$ 48.40
Low	$ 16.76	$ 22.87	$ 22.42	$ 29.39
2005				
High	$ 20.52	$ 19.77	$ 18.79	$ 17.80
Low	$ 17.90	$ 15.43	$ 16.05	$ 14.60

Dividends

In line with its policy of semi-annual consideration of a dividend the Company declared the following cash dividends for the two years ended December 31, 2006.

Date declared	Stockholders of record	Date paid	Amount per share
February 4, 2005	February 18, 2005	April 1, 2005	7 cents
August 12, 2005	August 31, 2005	September 30, 2005	7 cents
February 16, 2006	February 23, 2006	April 1, 2006	8 cents

August 18, 2006	September 1, 2006	October 1, 2006	8 cents

In addition, on February 26, 2007 the Company announced that its Board of Directors had declared a semi-annual dividend of 9 cents per share payable on April 2, 2007 to stockholders of record as of March 5, 2007.

The refinancing facility entered into on December 13, 2005 allows a maximum dividend of $2.5 million per annum in 2005, plus 10% annual growth thereafter, provided that no default has occurred or would result from such payment. The Company may repurchase its own common stock provided that this will not affect compliance with the financial covenants in the facility.

Table of Contents

ISSUER PURCHASES OF EQUITY SECURITIES

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of the Publicly Announced Plans or Programs	(d) Approximate Dollar Value of Shares that May Yet Be Purchased Under the Plans or Programs
Carried forward				0.3
December 4 additional approval				20.0
October 1 - October 31	26,831	29.85	26,831	(0.8)
November 1 - November 30				
December 1 - December 31	2,947	44.07	2,947	(0.1)
Total	29,778	31.52	29,778	19.4

Repurchases of common stock are held as treasury shares unless reissued under equity compensation plans.

On May 1, 2006 the Board of Directors of Innospec Inc. confirmed that the amount outstanding under approved share buyback programs, all of which had no expiration date, was $11.9 million at March 31, 2006.

On May 2, 2006 the Company announced that the Board of Directors of Innospec Inc. had authorized a further stock re-purchase plan. The plan commenced on May 8, 2006 and completed on July 26, 2006. Under that plan the Company had the ability to re-purchase up to 420,000 shares of common stock.

On August 18, 2006 the Company announced that the Board of Directors of Innospec Inc. had authorized a further stock re-purchase plan under Rule 10b5-1 to repurchase an additional $2.0 million of common stock. This plan commenced on August 28, 2006 and completed on October 17, 2006.

On December 4, 2006 the Company announced that the Board of Directors of Innospec Inc. had authorized the repurchase of up to $20.0 million of common stock, dependent on market conditions, and a further stock re-purchase plan under Rule 10b5-1 to repurchase an additional $2.5 million of common stock. This plan commenced on December 5, 2006 and completed on February 9, 2007.

On February 26, 2007 the Company announced that the Board of Directors of Innospec Inc. had authorized a further stock re-purchase plan under Rule 10b5-1 to repurchase up to an additional $5.0 million of common stock. This plan commenced on February 28, 2007 and is scheduled to complete on May 4, 2007.

The Company has authorized securities for issuance under equity compensation plans. The information contained in Item 12 under the heading Shares Authorized for Issuance under Equity Compensation Plans is incorporated herein by reference.

The Company has not, within the last three years, made any sales of unregistered securities.

Table of Contents

Item 6 Selected Financial Data

FINANCIAL HIGHLIGHTS

(dollar amounts in millions except per share figures)	2006 [1]	2005 [1] [2]	2004 [1] [2]	2003 [1] [2]	2002
Summary of performance					
Net sales [3]	$ 532.1	$ 564.8	$ 496.9	$ 471.8	$ 467.8
Impairment of Octane Additives business goodwill	(36.7)	(134.4)	(40.7)		
Operating income/(loss)	31.9	(97.7)	41.7	97.9	89.7
Income/(loss) before income taxes and minority interest	31.9	(117.9)	34.0	81.6	77.6
Minority interest	(0.1)	(0.2)	(2.0)	(4.3)	(3.0)
Income taxes	(20.4)	(4.2)	(20.1)	(23.2)	(23.0)
Income/(loss) after income taxes from continuing operations	11.4	(122.3)	11.9	54.1	51.6
Net income/(loss)	11.4	(123.7)	6.2	51.8	52.1
Net cash provided by operating activities	36.4	43.8	62.4	85.2	100.0
Financial position at year end					
Working capital [4]	97.9	52.7	54.5	36.1	40.8
Total assets	569.0	675.3	790.6	741.6	747.8
Long-term debt (including current portion)	148.1	144.6	124.3	104.6	159.2
Stockholders equity	$ 225.0	$ 314.4	$ 445.8	$ 430.2	$ 362.5
Financial ratios					
Net income/(loss) as a percent of sales	2.1	(21.9)	1.2	11.0	11.1
Effective income tax rate as a percent [5]	64.2	(3.5)	62.8	30.0	30.8
Current ratio [6]	2.1	1.7	1.2	1.6	0.9
Share data					
Earnings per share					
Basic	0.94	(10.00)	0.50	4.34	4.41
Fully diluted	0.90	(10.00)	0.48	4.13	4.15
Earnings per share from continuing operations					
Basic	0.94	(9.89)	0.96	4.53	4.36
Fully diluted	0.90	(9.89)	0.92	4.31	4.11
Dividend paid per share	0.16	0.14	0.12	0.05	0.05
Shares outstanding (basic, thousands)					
At year end	11,903	12,325	12,337	12,059	11,843
Average during year	12,071	12,368	12,345	11,925	11,817
Stock price					
High	48.40	20.52	32.00	20.48	26.09
Low	16.76	14.60	18.62	12.56	15.80
At year end	46.55	16.27	20.81	19.69	15.80

(1) From January 1, 2002, the amortization of goodwill ceased in accordance with FAS 142.

(2) 2005, 2004, 2003 and 2002 comparatives have been restated in order to reflect discontinued operations.

Table of Contents

(3) Net sales have been revised in order to reflect the revised classification of certain shipping and handling costs and commission charges.
(4) Working capital comprises accounts receivable, inventories, prepaid expenses, accounts payable and accrued liabilities.
(5) The effective tax rate is calculated as a percentage of income before income taxes.
(6) Current ratio is defined as current assets divided by current liabilities.

QUARTERLY SUMMARY (UNAUDITED) (see Note 3 below)

(dollar amounts in millions except per share data)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2006				
Net sales	$ 124.3	$ 119.4	$ 143.7	$ 144.7
Gross profit	46.5	42.1	51.6	46.5
Operating income	6.6	3.9	19.8	1.6
Net income/(loss)	0.6	1.0	10.5	(0.7)
Net cash (used)/provided by operating activities	$ (7.7)	$ 8.4	$ 19.6	$ 16.1
Per common share:				
Earnings/(loss) basic	$ 0.05	$ 0.08	$ 0.88	$ (0.06)
fully diluted [1]	$ 0.05	$ 0.08	$ 0.84	$ (0.06)
2005				
Net sales	$ 142.3	$ 134.8	$ 143.5	$ 144.2
Gross profit	52.9	47.7	48.5	51.0
Operating income/(loss) [2]	1.0	(99.2)	1.1	(0.6)
Net (loss)/income	(2.4)	(104.8)	(9.1)	(7.4)
Net cash provided by operating activities	$ 10.3	$ (13.9)	$ 19.5	$ 27.9
Per common share:				
Loss basic	$ (0.19)	$ (8.46)	$ (0.74)	$ (0.61)
fully diluted	$ (0.19)	$ (8.46)	$ (0.74)	$ (0.61)

NOTES

(1) In view of the fact that a net loss of $0.7 million was made in the fourth quarter, 2006, the basic and fully diluted loss per common share are the same for that quarter. However, on an annual basis the fully diluted earnings per common share was $0.90, meaning that effectively the impact of the fourth quarter loss on fully diluted earnings was a loss of $0.07.

(2) The figures for 2005 have been restated in order to reflect discontinued operations. This had no impact on cash flows.

(3) During the final quarter, 2006, the Company revised the classification of certain shipping and handling costs and commission charges in its results for 2006 and comparable information for 2005 and 2004. Previously, these charges were netted off sales and are now charged to cost of goods sold and selling expenses, respectively. This has no impact on 2006 or any prior periods reported income before income taxes, net income, earnings per share, net cash provided by operating activities or any balance sheet category. The classification of charges of $28.6 million and $37.1 million for the years ended December 31, 2006 and 2005, respectively, (1) with respect to shipping and

handling costs has been revised from a reduction in net

Table of Contents

sales to an increase in costs of goods sold of $23.1 million and $26.5 million, respectively, and (2) with respect to commission charges has been revised from a reduction in net sales to an increase in selling expenses of $5.5 million and $10.6 million, respectively. The impact on net sales, gross profit and selling, general and administrative expenses for the previously reported quarters, and the 2006 fourth quarter, during the two years ended December 31, 2006 is provided below:

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Full Year 2006
Previously reported:					
(in millions)					
Net sales	$ 117.9	$ 112.9	$ 135.5	$ 137.2	$ 503.5
Gross profit	$ 45.5	$ 41.0	$ 49.5	$ 45.2	$ 181.2
SG&A expenses	$ (21.1)	$ (21.0)	$ (22.2)	$ (29.2)	$ (93.5)
Revised classification:					
(in millions)					
Net sales	$ 124.3	$ 119.4	$ 143.7	$ 144.7	$ 532.1
Gross profit	$ 46.5	$ 42.1	$ 51.6	$ 46.5	$ 186.7
SG&A expenses	$ (22.1)	$ (22.1)	$ (24.3)	$ (30.5)	$ (99.0)

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Full Year 2005
Previously reported:					
(in millions)					
Net sales	$ 133.2	$ 125.8	$ 133.0	$ 135.7	$ 527.7
Gross profit	$ 50.2	$ 45.8	$ 45.0	$ 48.5	$ 189.5
SG&A expenses	$ (25.8)	$ (24.9)	$ (20.1)	$ (26.8)	$ (97.6)
Revised classification:					
Net sales	$ 142.3	$ 134.8	$ 143.5	$ 144.2	$ 564.8
Gross profit	$ 52.9	$ 47.7	$ 48.5	$ 51.0	$ 200.1
SG&A expenses	$ (28.5)	$ (26.8)	$ (23.6)	$ (29.3)	$ (108.2)

Table of Contents

Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations

This discussion should be read in conjunction with our consolidated Financial Statements and the notes thereto, included elsewhere herein.

FACTORS AFFECTING OUR RESULTS

The primary factor affecting our results of operations is the continuing transformation of the Company s business from one which was focused on Octane Additives to one in which the Fuel Specialties and Performance Chemicals segments play an increasingly predominant role. For the year ended December 31, 2006, the combined operating income of the Fuel Specialties and Performance Chemicals segments of our business rose 89%, as compared with the year ended December 31, 2005. By comparison, for the year ended December 31, 2006, operating income for the Octane Additives segment was $34.5 million, which represents a decline of approximately 50% from operating income for the Octane Additives segment of our business for the year ended December 31, 2005. We expect that the role of the Octane Additives segment of our business will continue to decline in the coming years. We expect that we will cease all sales of TEL for use in automotive gasoline at some time in the future, and that we will continue to write-off the business goodwill for our Octane Additives business until or prior to that point. The Company s strategic plan is for the growth in the Fuel Specialties and Performance Chemicals segments to off-set the decline in the Octane Additives business.

Revision to Classification of Certain Items

During the final quarter, 2006, the Company revised the classification of certain shipping and handling costs and commission charges in its results for 2006 and comparable information for 2005 and 2004. Previously, these charges were netted off sales and are now charged to cost of goods sold and selling expenses, respectively. This has no impact on 2006 or any prior periods reported income before income taxes, net income, earnings per share, net cash provided by operating activities or any balance sheet category.

The classification of charges of $28.6 million, $37.1 million and $28.8 million for the years ended December 31, 2006, 2005 and 2004, respectively, (1) with respect to shipping and handling costs has been revised from a reduction in net sales to an increase in costs of goods sold of $23.1 million, $26.5 million and $21.8 million, respectively, and (2) with respect to commission charges has been revised from a reduction in net sales to an increase in selling expenses of $5.5 million, $10.6 million and $7.0 million, respectively.

The Company undertook an analysis of the aggregate effect of these reclassifications on its gross margin for each of 2006, 2005 and 2004. As originally reported, gross margin for the year ended December 31, 2005 was 35.9%. After giving effect to the reclassifications, gross margin would decline by an absolute amount of 0.5 percentage points, to 35.4%, which represents a 1.3% reduction of the gross margin relative to what was originally reported. Similarly, for the year ended December 31, 2004, the gross margin after giving effect to the reclassifications declined from 44.0% to 42.9%, an absolute reduction of 1.1 percentage

Table of Contents

points, which represents a 2.6% reduction in gross margin relative to the gross margin under the originally reported financial statements.

RESULTS OF OPERATIONS

Results of Operations Fiscal 2006 compared to Fiscal 2005:

The following table showing operating income by reporting business, and also applies to the comparative results of operations in 2005 and 2004.

Product Group Data

(in millions)	2006	2005	2004
Net sales:			
Fuel Specialties	$ 311.3	$ 257.1	$ 208.9
Performance Chemicals	120.4	109.4	48.6
Octane Additives	100.4	198.3	239.4
	$ 532.1	$ 564.8	$ 496.9
Gross profit:			
Fuel Specialties	$ 106.2	$ 83.5	$ 70.1
Performance Chemicals	22.7	17.6	8.8
Octane Additives	57.8	99.0	134.1
	$ 186.7	$ 200.1	$ 213.0
Operating income:			
Fuel Specialties	$ 45.7	$ 26.2	$ 20.8
Performance Chemicals	5.8	1.0	0.2
Octane Additives	34.5	69.2	104.4
FAS 87 pension (charge)/credit		(1.7)	2.7
Corporate costs	(22.1)	(26.7)	(33.0)
Restructuring charge	(4.5)	(31.3)	(8.3)
Impairment of Octane Additive business goodwill	(36.7)	(134.4)	(40.7)
Profit/(loss) on disposals (net)	9.2		(4.4)
Operating income/(loss)	$ 31.9	$ (97.7)	$ 41.7

Net sales

(in millions)	2006	2005	Change	
Fuel Specialties	$ 311.3	$ 257.1	$ 54.2	+21%
Performance Chemicals	120.4	109.4	11.0	+10%
Octane Additives	100.4	198.3	(97.9)	-49%
	$ 532.1	$ 564.8	$ (32.7)	-6%

Fuel Specialties is now by far our largest business unit accounting for well over half of our revenues. The revenue increase of 21% achieved by this business unit was focused in the

Table of Contents

Europe, Middle East and Africa (EMEA) region and the Americas region, which delivered revenue growth of 17% and 21%, respectively. There were also strong sales in the Asia Pacific (ASPAC) region which delivered revenue growth of 60% albeit from a much lower base. Americas sales were driven by our strong market-leading position in diesel fuel additives and the U.S. government s adoption early in 2006 of new ultra low sulfur diesel regulations. Approximately half of the EMEA sales growth was due to a one-off contract with a single customer. The ASPAC growth was due to the benefit generated from customer contracts entered into early in 2006.

The Performance Chemicals sales growth in 2006 was spread across each of the individual operations which comprise this business. In absolute dollar terms however, the growth was focused in Aroma Fine Chemicals, our aroma fragrances business, and Finetex, our surfactants and emollients business. Aroma Fine Chemicals benefited from price increases throughout 2006 and greater production capacity which came on stream in the latter stages of the year. During 2006 Finetex leveraged its customer base to increase both sales prices and volumes across almost all of its product range.

The Octane Additives sales decline was limited to 49% in dollar terms despite volumes decreasing 63%. This was primarily due to the richer sales mix in 2006, compared to 2005, and moderate price increases achieved during 2006. Sales volumes were adversely impacted by South Africa leaving the market for TEL for use in automotive gasoline at the start of the year, and the absence in 2006 of significant shipments to South East Asia. However, sales to the Middle East in 2006 remained resilient.

In aggregate terms the sales decline was limited to $32.7 million (6%) as the combined sales growth of our Fuel Specialties and Performance Chemicals businesses of $65.2 million (18%) went a long way in mitigating the expected continued sales decline in our Octane Additives business.

Gross profit

(in millions)	**2006**	**2005**	**Change**	
Fuel Specialties	$ 106.2	$ 83.5	$ 22.7	+27%
Performance Chemicals	22.7	17.6	5.1	+29%
Octane Additives	57.8	99.0	(41.2)	-42%
	$ 186.7	$ 200.1	$ (13.4)	-7%
Gross margin (%)				
Fuel Specialties	*34.1*	*32.5*	*+1.6*	
Performance Chemicals	*18.9*	*16.1*	*+2.8*	
Octane Additives	*57.6*	*49.9*	*+7.7*	
Aggregate	*35.1*	*35.4*	*-0.3*	

The 27% increase in gross profit generated by our Fuel Specialties business outstripped the 21% sales growth achieved due to improved margins. The increase of 1.6 percentage points in

Table of Contents

the Fuel Specialties gross margin was focused in the Americas region and offset the lower margins seen in the EMEA and ASPAC regions. The Americas gross margin benefited from sales prices increases implemented early in 2006 and tight control of material costs throughout the year. The EMEA gross margin was diluted by the impact of a one-off contract with a single customer and the ASPAC gross margin was impacted by product mix.

The Performance Chemicals business delivered a 29% increase in gross profit which again was significantly in excess of the 10% sales growth. This increase was generated from a 2.8 percentage points improvement in gross margins spread across each of the individual operations which comprise this business segment. This gross margin improvement was focused in Finetex, Innospec Leuna and ProChem with the latter two businesses benefiting from product mix improvements.

The 42% decline in gross profit in our Octane Additives business compares favourably to the 49% decrease in sales. This is due to the 7.7 percentage points improvement in gross margin which reflects the richer sales mix and moderate price increases achieved during 2006.

Overall gross profit declined 7% to $186.7 million, compared to the sales decline of 6%, despite each of our businesses actually managing to increase their gross margins. This is due to the fact that higher margin Octane Additives sales formed a smaller proportion of total sales, reducing from 35% to 19%, with this mix effect depressing the aggregate gross margin by 0.3 percentage points.

Operating expenses

(in millions)	2006	2005	Change	
Fuel Specialties	$ (59.3)	$ (56.1)	$ (3.2)	+6%
Performance Chemicals	(15.5)	(15.2)	(0.3)	+2%
Octane Additives	(13.2)	(19.7)	6.5	-33%
FAS 87 pension (charge)/credit		(1.7)	1.7	-100%
Corporate costs	(22.1)	(26.7)	4.6	-17%
	$ (110.1)	$ (119.4)	$ 9.3	-8%

Increases in operating expenses in our Fuel Specialties and Performance Chemicals businesses have been limited to 6% and 2%, respectively, despite the sales growth of 21% and 10%, respectively. This sales growth and tight cost control has been achieved by leveraging the infrastructures of these businesses.

The 33% reduction in operating expenses of Octane Additives compares to the 49% sales decline experienced in this business. The majority of the savings were generated from reduced commission charges caused by the absence of sales to South East Asia.

In accordance with FAS 87, we were required to recognize a non-cash charge of $1.7 million in 2005, primarily in respect of the amortization of prior service cost. No similar charge was required to be recognized in 2006.

Table of Contents

The reduction achieved in corporate costs results from the restructuring of the corporate functions and reduced costs in relation to Sarbanes Oxley compliance. There were also significant costs recognized in 2005 for the special investigation into the transfer of funds in South Africa by the former CEO.

Restructuring charge

Restructuring costs of $4.5 million in 2006, substantially reduced from the $31.3 million incurred in 2005, were comprised of severance and other restructuring costs of $2.4 million and $2.1 million, respectively.

The severance costs included $1.6 million in respect of cost reduction programs in manufacturing and support activities on the U.K. Octane Additives manufacturing site, $0.6 million in respect of additional salary and other emoluments to be paid to the former CEO and $0.2 million in relation to severance of corporate staff.

The other restructuring costs comprised $1.4 million in respect of site clearance in the U.K., $0.4 million in relation to costs associated with a plan to consolidate manufacturing activities on to one site in one of our U.S. businesses and $0.3 million in respect of the relocation of our European Headquarters to the Ellesmere Port site.

Amortization of intangible assets

The amortization charge was $12.7 million in 2006 and 2005. In both years a charge of $10.1 million was recognized in respect of the Veritel intangible asset that is being amortized on a straight-line basis and as such is comparable year on year. The remaining $2.6 million in both years relates to the amortization of intangible assets recognized in the acquisition accounting in respect of Finetex, Aroma Fine Chemicals and Innospec Fuel Specialties (formerly known as Octel Starreon).

Impairment of Octane Additives business goodwill

The Company recognized a charge of $36.7 million for the impairment of Octane Additives business goodwill in 2006. This compares to a charge of $134.4 million in 2005. Since the end of 2005 there have been no significant changes in the estimates used in the detailed forecast model to calculate the impairment charges. The charge was significantly higher in 2005 due to the loss of anticipated sales and associated cash flows from Venezuela, a major customer, in the second quarter of 2005.

The remaining balance of Octane Additives business goodwill is now $24.8 million. The Company will continue to test the value of Octane Additives business goodwill at the end of each quarter and expects to recognize a charge of approximately $14 to $18 million for the 12 months ending December 31, 2007, if actual cash flows are in line with the Company s current forecasts. The charge remains critically dependent upon developments that affect the Company s best estimates of future volumes of Octane Additives, future revenue, gross margins, selling and administrative costs as well as the fixed and working capital requirements

Table of Contents

of the business, including the level of compensation paid to Ethyl under the TEL marketing agreements.

Profits/(loss) on disposal (net)

The Company recognized $9.6 million profit following the disposal of surplus real estate in the U.K. This was partially off-set by prepaid disposal costs of $0.4 million.

Interest expense (net)

Net interest expense in 2006 at $6.8 million was $0.8 million lower than the $7.6 million incurred in 2005. This reduction is primarily due to the fact that average net debt was lower in 2006 when compared to 2005; and also due to the inclusion in the 2006 net charge of repayment of interest of $0.6 million charged on a tax balance. Net debt fell by $25.2 million, between the end of 2005 and 2006, primarily due to the $36.4 million of cash flows from operating activities generated by our businesses and the $9.6 million of proceeds from the disposal of surplus real estate in the U.K., offset by $15.6 million of common stock repurchased. Moreover, this reduced net interest expense was achieved despite the fact that the U.S. base interest rate rose between the corresponding periods.

Other net income/(expense)

In 2006 other net income of $6.8 million was generated of which $7.6 million related to foreign exchange gains offset by $0.8 million of other sundry expenses.

In 2005 other net expense of $12.6 million comprised a $5.5 million charge for the write-off of the Company s investment in Stylacats in the third quarter, a charge of $1.2 million to fully provide against two other investments, a $3.7 million charge for exchange losses on forward foreign exchange contracts and $2.2 million of other sundry expenses.

Income taxes

The Company recognized a tax charge of $20.4 million in 2006 which is $16.2 million greater than the $4.2 million incurred in 2005. The headline rate of income tax is 64.2% compared to (3.5)% in 2005. However, the effective rate of tax for 2006 excluding the impairment of Octane Additives business goodwill was 29.8% compared to 25.8% in 2005.

Tax relief is not available on this impairment charge and accordingly we believe that the effective rate of tax is best calculated by adjusting for this non-cash charge. This adjusted effective rate has increased 4.0 percentage points between the corresponding periods due to the disposition of our profits, exhaustion of U.S. net operating losses and increased profitability of our U.S. based Fuel Specialties business which suffers the standard federal tax rate of 35%, together with state taxes.

Results of Operations Fiscal 2005 Compared to Fiscal 2004:

The following table is presented to show the incremental impact of the acquisitions of Leuna, Aroma Fine Chemicals (AFC) and Finetex in 2005.

32

Table of Contents

Effect of acquisitions on 2005 group results compared to 2004

(in millions)	2005 As Reported	Effect of Acquisitions	2005 Before Acquisitions	2004 As Reported
Net sales	$ 564.8	$ 62.3	$ 502.5	$ 496.9
Gross profit	200.1	7.2	192.9	213.0
Selling general and administrative expense	(108.2)	(6.2)	(102.0)	(96.6)
Research and development expense	(11.2)	(0.7)	(10.5)	(10.1)
Amortization of intangible assets	(12.7)	(1.5)	(11.2)	(11.2)
Impairment of TEL business goodwill	(134.4)		(134.4)	(40.7)
Restructuring charge	(31.3)	(0.4)	(30.9)	(8.3)
Loss on disposals				(4.4)
Operating Income	$ (97.7)	$ (1.6)	$ (96.1)	$ 41.7

The table above includes the impact of the acquisition of Leuna, the results of which were consolidated for six months in 2004, and the results of AFC, the results of which have been consolidated for four months in 2004 and the results of Finetex which was acquired in January 2005. The impact of the acquisition of the remaining 50% of the shares in Innospec Fuel Specialties LLC (formerly known as Octel Starreon LLC) has not been included as the results of Innospec Fuel Specialties LLC have been fully consolidated by the Company since the inception of the joint venture in 1999, with a corresponding charge in the minority interest line item. The minority interest charge for the period to full acquisition of Innospec Fuel Specialties LLC on July 8, 2004 was $1.9 million. Accordingly no table of the impact of acquisitions is presented for the Fuel Specialties business.

The effect of acquisitions on 2005 Performance Chemicals business results compared to 2004 is as follows:

(in millions)	2005 As Reported	Acquisitions Effect	Performance Chemicals Before Acquisitions 2005	2004 As Reported
Net sales	$ 109.4	$ 59.3	$ 50.1	$ 48.6
Gross profit	17.6	6.4	11.2	8.8
Selling general and administrative expense	(13.2)	(6.1)	(7.1)	